STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 09-0166
Proposed General Increase In Rates For Gas Service.	:	and
	:	No. 09-0167
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	Consol.
	:	
Proposed General Increase In Rates For Gas Service.	:	

REPLY BRIEF ON EXCEPTIONS OF NORTH SHORE GAS COMPANY
AND THE PEOPLES GAS LIGHT AND COKE COMPANY

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North Shore Gas Company ("North Shore" or "NS") and The Peoples Gas Light and Coke Company ("Peoples Gas" or "PGL") (together, "the Utilities"), in accordance with the schedule set in the Administrative Law Judges' (the "ALJs") Proposed Order of November 6, 2009 (the "Proposed Order" or "ALJPO"), and Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (the "Commission" or "ICC"), 83 Ill. Adm. Code § 200.830, submit this Reply Brief on Exceptions.

INTRODUCTION AND SUMMARY

The Proposed Order's recommendations for the most part are consistent with the evidence and the law. However, its figures for the Utilities' total test year costs of service to be recovered through base rates (their revenue requirements), due to several incorrect rulings, fall short of their actual costs of service, as shown in the Utilities' Brief on Exceptions.

"AG-CUB-City" and the Commission's Staff ("Staff"), in their respective Exceptions, nonetheless urge additional incorrect adjustments, that the Proposed Order rejected, that would only deepen the Utilities' cost recovery shortfalls, just as they did in the Utilities' 2007 rate cases. Their adjustments would lead to new rates that will not recover the Utilities' actual costs of service even in the year that they go into effect, just as occurred with the 2007 rate cases.

The Utilities' existing rates, which are the rates that were set in their 2007 rate cases based on an adjusted historical fiscal year 2006 that ended September 30, 2006, went into effect on February 14, 2008. The Utilities have shown that, despite those new rates, they fell significantly short of recovering their actual costs of service in 2008. *E.g.*, NS-PGL BoE at 6. Even more importantly, the Utilities have shown that their existing rates will significantly under-recover their costs of service in the uncontested 2010 test year that is being used in the current cases, and they have shown the specific drivers of their 2010 test year cost recovery shortfalls under their existing rates. *E.g.*, *id*. at 5-7.

The Utilities anticipated that their use of a future test year in the current cases, unlike the use of an adjusted historical 2006 test year in their 2007 rate cases, would lead to new rates that will allow them the opportunity to recover fully their actual costs of service, as is their constitutional and statutory right. NS-PGL BoE at 4. However, the Proposed Order recommends revenue requirements that are over $50 million short of the Utilities' 2010 test year costs of service (*e.g.*, NS-PGL BoE at 2-3, 13-14), and the AG-CUB-City[1] and Staff Exceptions would only make things worse, to the long-term detriment of all. Large cost recovery shortfalls increase a utility's costs of capital over time and are incompatible with sustaining a utility that is able to provide safe, adequate, and reliable service over the long term. NS-PGL BoE at 4-5.

The Exceptions of AG-CUB-City and Staff are replete with errors that would prevent the Utilities from recovering their actual costs of service, including their costs of capital. CUB-City and Staff continue to assert that the Utilities use short-term debt to finance rate base assets, but

1 The Illinois Attorney General's Office (the "AG"), the Citizens Utility Board ("CUB"), and the City of Chicago (the "City"). The AG, CUB, and the City have filed testimony and briefs in different combinations over the course of these cases, including three Briefs on Exception, one by the AG, one by CUB-City, and one by CUB. For simplicity's sake, the Utilities use the term "AG-CUB-City" herein when those three parties appear to be aligned.

fail to support their assertion with evidence. CUB-City continue to press for authorized rates of returns on equity that are significantly lower than any returns this Commission has set for a natural gas utility in at least 40 years. Staff joins CUB-City in this regard, proposing on Exceptions a new financial model result based on a mixture of inputs from the Utilities and Staff experts that is even lower than the result recommended and sworn to by Staff's own expert. This appears to be the first time that a party to an ICC rate case has abandoned its position on cost of equity at hearing for a more aggressive position at the Exceptions Stage.

AG-CUB-City and Staff also continue to propose many other erroneous, arbitrary, and inconsistent adjustments. Staff seeks to include the North Shore pension liability in rate base while excluding the Peoples Gas pension asset, an inconsistent position that not only is rejected by the Proposed Order but is contrary to the Order in the Utilities' 2007 rate cases.[2] AG-CUB-City wants to incorrectly whittle away at the very small amount of incentive compensation allowed by the Proposed Order. Staff wants to reduce the Utilities' Cash Working Capital in rate base by substituting an incorrect imaginary figure of zero for actual revenue lag numbers for pass-through taxes. Staff also wants to disallow prudent and reasonable inspection and maintenance costs based on its misinterpretation of a past Commission Order. The list goes on. Time and again, the adjustments urged by AG-CUB-City and Staff are not supported by or are contrary to the evidence, and they often are arbitrary and/or inconsistent. Their results-driven attempts to drive down the Utilities' approved revenue requirements are inappropriate and must be rejected.

[2] *In re North Shore Gas Co., et al*., ICC Docket Nos. 07-0241/07-0242 Cons. (Order Feb. 4, 2008) ("*Peoples 2007*"), at 32-36.

Generally, the Proposed Order reached well-supported conclusions on key cost of service, rate design, and tariff issues. The AG and Staff raise limited Exceptions but continue to take positions that are contrary to basic cost causation principles, namely that those customers who cause the utility to incur costs should bear those costs and fixed costs should be recovered through fixed charges. The Proposed Order gave the Retail Gas Suppliers ("RGS") the benefit of the doubt. Rather than rejecting RGS' proposals on the merits, the Proposed Order concluded that all the RGS issues should be addressed in workshops, notwithstanding the dearth of evidence supporting changes to the Utilities' small volume transportation programs. RGS, however, persists in arguing that the issues should be decided on the merits in this case. If the Commission does so, then it should reject RGS' proposed changes.

The Commission should not adopt the substantive Exceptions proposed by intervenors and Staff, except for the Exception of Constellation NewEnergy - Gas ("CNE-Gas") relating to the revised super-pooling proposal. The Commission should adopt the Utilities' Exceptions.

ARGUMENT IN REPLY TO EXCEPTIONS

Please note that, for ease of reference, the Utilities, as in their Brief on Exceptions, are using the section numbering of the Proposed Order and are only incorporating those sections as to which they are replying to intervenor and Staff Exceptions.

IV. **<u>Rate Base</u>**

B. Uncontested Issues (All Subjects Relate to <u>North Shore and Peoples Gas Unless Otherwise Noted)</u>

2. <u>Plant</u>

a. Original Cost Determinations as to <u>Plant Balances as of 12/31/07</u>

The Proposed Order adopts the correct original cost figures for the Utilities' plant balances as of December 31, 2007. ALJPO at 8-9, 276.

Staff maintains its belated argument that the original cost determinations as to plant balances should be decreased by $166,000 for Peoples Gas and $27,000 for North Shore relating to capitalized incentive compensation not allowed for recovery in the Utilities' 2007 rate cases. Staff BoE at 1-3. Staff's adjustment is not discussed in testimony as it is contrary to Staff's witness' own proposal and it first was mentioned in Staff's Initial Brief ("Init. Br.") (at 5-6).

In contrast, the Proposed Order's original cost determinations as to the Utilities' plant balances are supported by the evidentiary record as Staff's witness and the Utilities' witness agreed that the Commission should make original cost determinations of the Utilities' plant balances as of December 31, 2007, for Peoples Gas of $2,525,147,000 and for North Shore of $398,983,000. Bridal Direct ("Dir.") Staff Exhibit ("Ex.") 5.0 at 8:165 - 9:184; Hengtgen Rebuttal ("Reb."), NS-PGL Ex. JH-2.0 at 17:371 - 18:383; *see also* Hengtgen Dir., NS Ex. JH-1.0 at 14:298-312; Hengtgen Dir., PGL Ex. JH-1.0 at 17:378 - 18:392. Thus, having agreed to language and figures with the Utilities, Staff now seeks to reduce the agreed amounts.

The incentive compensation disallowed in Utilities' 2007 rate cases is an issue on appeal. Hengtgen Reb., NS-PGL Ex. JH-2.0 at 16:345-346. If the Utilities prevail on appeal, the

Commission would have inappropriately reduced their original costs of plant figures. Therefore, the Utilities urge the Commission to approve the language contained in the Proposed Order.

Alternatively, if the Commission decides to accept Staff's new amounts for the original cost determinations, then the Commission's final Order should specify that if a decision in the Appellate Court or another court or a Commission decision on remand or in any other proceeding results in the disallowed plant in question being approved, then the original cost amounts should be restored to their full amounts of $2,525,147,000 original cost of plant for Peoples Gas and $398,983,000 original cost of plant for North Shore. The Utilities propose the following alternative language:

Recommended Language, in the Alternative

(ALJPO at 8-9)

(1) The Record

Utilities witness Hengtgen's proposal that the Commission's final Order include an original cost determination as to each utility is uncontested. Mr. Hengtgen proposed that the Order make such determinations, pursuant to 83 Ill. Adm. Code Part 510 and its Appendix A, regarding Peoples Gas' and North Shore's Gross Utility Plant balances as of December 31, 2007. PGL Ex. JH-1.0 at 17-18; NS Ex. JH-1.0 at 14.

Staff witness Bridal agreed that such a determination should be included in the Commission's final Order. He recommended that the Order state in part:

> It is further ordered that the $2,525,147,000 original cost of plant for Peoples Gas at December 31, 2007, as reflected on the Company's Schedule B-5, Page 1 of 2, Line 14, Column F; and the $398,983,000 original cost of plant for North Shore at December 31, 2007, as reflected on the Company's Schedule B-5, Page 1 of 2, Line 12, Column F, are unconditionally approved as the original costs of plant.

Staff Ex. 5.0 at 8-9. The Utilities agreed. NS-PGL Ex. JH-2.0 at 17–18. No witness disagreed. However, in its Initial Brief, Staff proposed a new adjustment reducing the original cost determination for plant balances at December 31, 2007 for Peoples Gas by $166,000 and for North Shore by $27,000. (Staff IB at 5-6) The Utilities disagreed for two reasons. First, Staff first raised this adjustment in its Initial Brief, and it is contrary to

Staff's own witness' proposal, to which the Utilities had agreed. Second, because incentive compensation from the 2007 rate cases is a contested issue on appeal, such an adjustment would inappropriately reduce plant balances if the Utilities prevail.

(2) Commission Analysis and Conclusion

The Commission accepts Staff's and the Utilities' recommendation to have the final order include original cost determinations pursuant to 83 Ill. Adm. Code 510 and Appendix A thereto. ~~The Commission finds the agreed to language to be reasonable and appropriate.~~ However, the Commission approves Staff's revised figures as proposed in its Initial Brief relating to capitalized incentive compensation not allowed for recovery in the Utilities' 2007 rate cases. If a decision in the Appellate Court or another court or a Commission decision on remand or in any other proceeding results in the plant in question being approved, then the original cost amounts should be restored to their full amounts of \$2,525,147,000 original cost of plant for Peoples Gas and \$398,983,000 original cost of plant for North Shore. ~~Accordingly, it is approved and the language is set forth in the Findings and Ordering section of this Order.~~

(ALJPO at 276)

(6) the \$~~2,525,147,000~~original costs of plant for Peoples Gas at December 31, 2007, as reflected on the Company's Schedule B-5, Page 1 of 2, Line 14, Column F; and the \$~~398,983,000~~original costs of plant for North Shore at December 31, 2007, as reflected on the Company's Schedule B-5, Page 1 of 2, Line 12, Column F, are adjusted to \$2,524,981,000 and \$398,956,000, respectively, to reflect reductions for the capitalized incentive compensation costs that were disallowed in each Utility's last rate case, ICC Docket Nos. 07-0241/0242 (cons.) and are unconditionally approved as the original costs of plant. If a decision in the Appellate Court or another court or a Commission decision on remand or in any other proceeding results in such plant in question being approved, then the original cost amounts should be restored to their full amounts of \$2,525,147,000 original cost of plant for Peoples Gas and \$398,983,000 original cost of plant for North Shore;

C. <u>Plant</u>

1. <u>Forecasted Plant Additions</u>

The Utilities agree with Staff's Exception (Staff BoE at 4), but they note that Staff inadvertently failed to underline three of the five words Staff proposed to add in its black-lined language. Staff's proposed additional language is "since it was sufficiently supported", not just "sufficiently supported".

E. <u>Cash Working Capital</u>

1. <u>Pass-Through Taxes</u>

Staff argues that the Proposed Order (at 24) errs with respect to the inclusion of pass-through taxes in the Utilities' revenue lags to determine cash working capital ("CWC"). Staff BoE at 4-8. The Proposed Order has it right on this issue of fact. Staff's arguments confuse the issue by inappropriately intermingling different facts and rationale of a different rate case involving a different utility for the facts here. In its Brief on Exceptions, Staff repeats many of its past arguments and as a result the Utilities incorporate all their arguments with respect to this issue in their Initial Brief (at 36-40) and Reply Brief (at 15-17). However, there are three Staff arguments that will be addressed herein.

First, Staff, after failing to provide any actual analysis related to pass-through taxes in this proceeding, argues that the Proposed Order ignored the analysis that Staff performed as requested by the Commission in the Utilities' 2007 rate cases. Staff BoE at 5. No schedules or exhibits (*i.e.*, quantitative analysis or revised lead lag study) were filed in support of Staff's incorrect position. Instead, over the course of direct and rebuttal testimonies, Staff only offered unsubstantiated and incorrect assertions to support its adjustment, which, at times, it abandoned when rebutted by the Utilities.

In direct testimony, Staff witness Mr. Ostrander argued that the payment of pass-through taxes could not have a revenue lag because they were not payment for utility service. Ostrander Dir., Staff Ex. 3.0 at 7:131-133. Mr. Ostrander concluded that the Utilities are merely acting as a collection agency. *Id*. at 7:136-137. However, the Utilities demonstrated that those assertions were incorrect. After describing the types of pass-through taxes and energy assistance charges, Utilities witness Mr. Hengtgen testified that the majority of the pass-through taxes and energy assistance charges were taxes or charges imposed by law on the Utilities and not the customers and were either collected through a separate charge prescribed by law or described within the statute as a charge for utility service. Hengtgen Reb., NS-PGL Ex. JH-2.0 at 12:244-263. Thus, the pass-through taxes are a component of utility service.

Then, in rebuttal, Mr. Ostrander appeared to abandon that argument and claimed that (1) pass-through taxes were not revenue so they could not have a revenue lag and (2) zero lag days for revenue taxes were used in the recent Northern Illinois Gas Company ("Nicor") rate case[3]. Ostrander Reb., Staff Ex. 17.0 at 6:101-110, 7:125-133, 10:190-192. As to Mr. Ostrander's first claim, he ignores the fact that the pass-through taxes are not recorded as either a revenue or an expense. Consistent thinking would require that because they are not recorded as expense, they cannot have an expense lead either. Still, Mr. Ostrander conveniently ignores the timing issues created in the collection and payment of the taxes by ignoring one side of the equation (the revenue lag). Hengtgen Reb. NS-PGL Ex. JH-2.0 at 13:270-279. However, even though the pass-through taxes are not recorded as revenue or expense, they do create timing issues in the collection and payment of the taxes. Hengtgen Dir., NS Ex. JH-1.0 at 20:427-430;

[3] *In re Northern Illinois Gas Co.*, ICC Docket No. 08-0363 (Order March 25, 2009) ("*Nicor 2008*"). There is an October 7, 2009, Order on Rehearing in *Nicor 2008*, but the scope of the rehearing was limited to the subjects of short term debt in the utility's capital structure and gas efficiency program standards (the latter became moot).

PGL Ex. JH-1.0 at 24:507-510; Hengtgen Reb., NS-PGL Ex. JH-2.0 at 13:274-277. As for Mr. Ostander's second argument, the Utilities demonstrated that the facts in *Nicor 2008* are inapposite. NS-PGL Init. Br. at 38-39; NS-PGL Reply Brief ("Rep. Br.") at 15-16. Nicor reportedly collects pass-through taxes, holds them for a time, and then remits the money to various municipalities. Hengtgen Sur., NS-PGL Ex. JH-3.0 at 8:160 – 9:172. That would indicate that Nicor bases its payments on actual cash collections from customers, which is different from the Utilities. Peoples Gas entered into an agreement with the City of Chicago, dated December 21, 2005 (NS-PGL Ex. JH-3.9), under which it pays, at a specific time, an <u>estimate</u> of the pass-through taxes owed to the City. North Shore and Peoples Gas both use this same process for all pass-through taxes, whether covered by the City agreement or not. Hengtgen Reb., NS-PGL Ex. JH-2.0 at 14:309-311. There clearly is a significant difference in methodology between the Utilities and Nicor that warrants different treatment by the Commission.

Second, Staff argues that the Proposed Order is flawed because it assumes that shareholders are making payments for pass-through taxes that have not been received by ratepayers. Staff BoE at 5-8. To support that allegation, Staff cites the City of Chicago Agreement.[4] The example that Staff cites in its Brief on Exceptions on page 6 only further supports the existence of a lag between billing and collections by illustrating that the collection and payment of pass-through taxes create timing differences. The Utilities bill customers for the pass-through taxes in their normal billing process. Customers do not pay the bills immediately to

[4] In footnote 7 of its Brief on Exceptions, Staff claims that the Utilities have created an ambiguity in the record and cites to page 2 and page 8 of the Agreement of the City (NS-PGL Ex. JH-3.9). However, page 8 is an attachment to the agreement and represents a hypothetical example for illustrative purposes as noted. It is unclear to the Utilities as to what ambiguity is created.

the Utilities when they receive their bills. In fact, customers' payments (or collections by the Utilities) occurs over several months after bills are issued. This "lag" in collection is the basis for the Utilities' calculation and use of lag days in its lead lag study. *See* NS-PGL Init. Br. at 38. There is a corresponding expense (payment) lead because the Utilities do not remit the taxes to the taxing authorities on the same day they issue the bills to the customers. The due dates of the taxes are based on statutory due dates or various agreements with the taxing authorities. This payment "lead" is the basis for the utilities calculation of or use of lead days in its lead lag study. *Id*. The Utilities, therefore, appropriately addressed the actual lags and leads for pass-through taxes in their study. Furthermore, Staff does not dispute the Proposed Order's conclusion (at 24) that Staff ignored the time from billing to collection, which supports the Utilities calculation of revenue lag days upon which the lead lag study was based. In short, the Proposed Order (at 24) correctly concludes that the Utilities make payments to the taxing authorities prior to receiving payments from customers.

Finally, Staff erroneously claims the Proposed Order is flawed in terms of its application of *Nicor 2008*. Because Staff repeats its past arguments with respect to *Nicor 2008*, the Utilities incorporate all their arguments with respect to this issue in their Initial Brief (at 36-40) and Reply Brief (at 15-17).

The Commission should approve the Proposed Order's conclusions (at 24) with respect to Cash Working Capital.

H. <u>OPEB Liabilities and Adjustment to Remove Pension Asset</u>

Staff argues that the Proposed Order (at 36-37) errs in excluding North Shore's pension liability from rate base even though the Peoples Gas pension asset also was excluded. Staff BoE at 9-13. The Utilities' main position with respect to this subject remains unchanged, namely that

Peoples Gas' pension asset, North Shore's pension liability, and the Utilities' OPEB liabilities should be included in the Utilities' rate bases. NS-PGL BoE at 9-11, 18-23. However, if the Commission determines that Peoples Gas' pension asset should be excluded from rate base, then North Shore's pension liability should also be excluded from rate base, as the Proposed Order (at 36-37) recommends and as the Commission ruled in the Utilities' 2007 rate cases. *See Peoples 2007* at 32-36. Staff's arguments are incorrect and must be rejected. In its Brief on Exceptions, Staff repeats many of its past arguments and as a result the Utilities incorporate all their arguments with respect to this issue in their Initial Brief (at 40-45), Reply Brief (at 17-23), and Brief on Exceptions (at 18-24). There is one Staff argument that will be addressed herein.

Staff claims that the evidentiary record in this proceeding is more developed with respect to North Shore's pension liability than in the Utilities' 2007 rate cases. Staff BoE at 11. Staff errs. As the Proposed Order correctly finds:

> The question then becomes whether Staff or the AG has treated North Shore's pension liability appropriately. Staff's entire argument and testimony, upon which the Commission is meant to overturn its prior decision, is that the "North Shore pension liability represents the amount of expense that has been recovered in rates and not yet contributed to the pension plan by the Company. Therefore, it represents a cost-free source of capital to the Company and must be a reduction of rate base." Staff Initial Brief at 37 and Staff Ex. 16.0 at 14. This is not a sufficient basis for adopting a different methodology here.

ALJPO at 37. Staff has not provided any additional evidence in this proceeding that warrants inclusion of the North Shore pension liability in rate base if the Peoples Gas pension asset is excluded. Furthermore, the Utilities note that even AG-CUB-City witness Mr. Effron did not advocate Staff's inconsistent treatment of the pension asset and pension liability, and, instead, proposed exclusion of both the Peoples Gas pension asset and the North Shore pension liability. Effron Dir., AG-CUB-City Ex. 1.0, 10:217-12:266; Effron Reb., AG-CUB Ex. 4.0, 5:62-6:85; *see also* Felsenthal Reb., NS-PGL Ex. AF-1.0, 21:448-449.

The accrued pension liability of North Shore results from, among other things, pension expense being greater than pension contributions. Felsenthal Reb., NS-PGL Ex. AF-1.0, 20:439 - 20:440. Fewer pension contributions mean less expected return on pension assets in the "FAS 87" calculation. *Id*. at 20:441-442. The pension asset and pension liability result from the same calculations under FAS 87. *Id*. at 20:442-443. To treat the accrued pension liability different from the prepaid pension asset is inconsistent and inappropriate. *Id.* at 20:443-444. Thus, if the Commission concludes that Peoples Gas' pension asset should be excluded from rate base, then North Shore's pension liability also should be excluded from rate base, as the Proposed Order recommends and as the Commission ruled in the 2007 rate cases.

V. Operating Expenses

C. Contested Issues

1. Incentive Compensation (Falls in Multiple Categories of O&M)

The Proposed Order recommends disallowance of nearly all of the Utilities' incentive compensation costs. ALJPO at 59-60; NS-PGL BoE at 25, 26 (tables). The Proposed Order's recommendation is based on adopting (1) three of Staff's four proposed adjustments to the Utilities' non-executive and executive incentive plan costs and (2) Staff's grounds for disallowing all of the Utilities' stock plan costs. *Id*. The Utilities believe that the Proposed Order thereby errs both factually and legally. NS-PGL BoE at 24-34.

Staff takes no Exception on the merits of this subject. Staff has identified certain figures that it believes to be incorrect in two subsidiary schedules of the Appendix to the Proposed Order *See* Staff BoE at 16-17. As the Utilities currently understand it, Staff's Exception has, at most, minimal effect on the total rate base and total operating expense Schedules in the Appendix and the figures in the body of the Proposed Order. The Utilities accordingly take no position on Staff's Exception.

AG-CUB-City, switching horses from their own witness' proposal and prior briefing arguing that only 50% of the Utilities' non-executive and executive incentive plan costs should be disallowed (Effron Dir., AG-CUB-City Ex. 1.0 at 19-21; AG Init. Br. Corrected ("Corr.") at 11-12; CUB-City Init. Br. at 8-9), now advocate as an Exception the only one of Staff's four proposed adjustments to those two plans' costs that the Proposed Order rejected, *i.e.*, Staff's theory that the plans' costs should be reduced because their program targets are not likely to be fully met. CUB-City BoE at 2-4; ALJPO at 59-60.[5]

The AG-CUB-City Exception, even setting aside its inconsistency with their own witness' proposal and prior briefing, lacks merit. The uncontradicted evidence of James Hoover, the only witness in these cases who is an expert on human resources, is that the targets for each of these two plans are set each year to motivate employee behavior and are considered achievable stretch goals designed to motivate employee achievement from a competitive level to an outstanding level. Hoover Reb., NS-PGL Ex. JCH-1.0 at 4:87 - 5:91; Hoover Surrebuttal ("Sur."), NS-PGL Ex. JCH-2.0 at 3:52 - 4:72. Moreover, Staff's adjustment here is based entirely on the unsound premise that because in 2008 Peoples Gas' reduction in system leaks was below target, and in 2007 and 2008 both Utilities' occupational safety performance was below target, that means that the 2010 targets are unlikely to be met. *See* Hathhorn Dir., Staff Ex. 1.0 at 10:213 - 11:236. That is no good reason for disregarding the 2010 forecast and Mr. Hoover's

[5] To be more precise, the Exception here was filed only by CUB-City, not by the AG, but, as noted earlier, for simplicity's sake, the Utilities use the term "AG-CUB-City" herein when those three parties appear to be aligned. It also should be noted, as indicated above, that Staff itself did not take Exception as to the Proposed Order's rejection of this component of Staff's position.

testimony about the targets. Indeed, Staff's witness made no actual response to Mr. Hoover's rebuttal testimony on this point, and just repeated the points made in her direct testimony noted above. *See* Hathhorn Reb., Staff Ex. 15.0 Cor. at 12:290-293, *et seq*. Finally, the Proposed Order, when rejecting this Staff ground, noted that cutting incentive compensation tied to goals that have not been achieved in the past, which here include two operational goals that the Commission would like to see achieved, is not likely to increase the probability of those goals being met. ALJPO at 59-60. That is only logical. The plans serve to create incentives to meet their goals, as Mr. Hoover explained. AG-CUB-City's tortured logic (CUB-City BOE at 2-3), that if the goals are unlikely to be achieved then the incentives associated with those goals should be disallowed, starts from the assumed but erroneous premise that the goals are unlikely to be achieved and disregards that the incentives are designed to increase the likelihood of the goals being met. The AG-CUB-City Exception should be rejected.

2. <u>Non-union Base Wages</u> (Agreed in Part) (Falls in Multiple Categories of O&M)

Staff proposes only a technical Exception here that would change some citations. Staff BoE at 17. The Utilities do not oppose Staff's Exception.

3. <u>Head Counts</u> (Falls in Multiple Categories of O&M)

The Proposed Order correctly concludes that AG-CUB-City's proposed adjustment with respect to Peoples Gas' head count should be rejected. ALJPO at 65. [6] AG-CUB-City argue that

[6] The Proposed Order approved Mr. Effron's proposed adjustment as to North Shore's headcount, which involved only 3 employees, amounting to a disallowance of $124,000. ALJPO at 65 and Appendix B at p. 3, column (p). The Utilities, in order to narrow the issues, did not submit an Exception to that recommendation, although they do not believe it to be warranted.

In their Brief on Exceptions and separately filed proposed Exceptions language, in several spots, the Utilities listed the revenue requirement-related items as to which, in order to narrow the issues, they were not filing an Exception. *E.g.*, NS-PGL BoE at 14, fn. 16. The North Shore head count adjustment inadvertently was omitted from each of those lists.

the evidence does not support the Proposed Order's conclusion. CUB-City BoE at 4. The AG-CUB-City argument is meritless. Staff's Initial Brief agreed that the AG-CUB-City proposal should be rejected as to Peoples Gas based on the evidence (while taking no position as to North Shore). Staff Init. Br. at 69.

AG-CUB-City witness Mr. Effron proposed a disallowance based on his conclusion that Peoples Gas and North Shore will not have as many employees in 2010 as they forecast. Mr. Effron's evidence is rather thin on this point, however, to say the least. As of mid-2009, Peoples Gas' employee headcount had not risen appreciably from 2008 levels, so Mr. Effron therefore theorized that it also would not increase by the test year, 2010. Effron Dir., AG-CUB-City Ex. 1.0 at 17:377 – 18:385; Effron Reb., AG-CUB Ex. 4.0 at 8:134-42.

Mr. Effron's cursory analysis cannot overcome Peoples Gas' testimony indicating that it would be hiring more employees. Aside from the budget, Edward Doerk, Peoples Gas' Vice President of Gas Operations, testified that Peoples Gas had specific plans to bring on new employees, in large part to comply with a Commission Order. Doerk Reb., NS-PGL Ex. ED-2.0 at 6:130 – 7:137. In fact, 36 of the 47 new positions are specifically related to implementation plans designed to address recommendations of the Liberty Consulting Group in their August 2008 report. *Id*.

Moreover, Mr. Doerk was able to update the status of the new hires in his August 2009 surrebuttal testimony. Since June 2009 (and therefore post-dating the information on which Mr. Effron's proposal relied), Peoples Gas had hired 27 new Operations Apprentices and 5 new Operations Specialists, and was interviewing additional candidates. Doerk Sur., NS-PGL Ex. ED-3.0 at 3:62 – 4:66. That demonstrates that Peoples Gas' forecast is realistic, that it is not going to ignore the Liberty recommendations, and that Mr. Effron's proposed decrease should be rejected. The Commission should reject AG-CUB-City's Exception.

4. <u>Distribution Expenses – Liberty Audit Adjustment</u>

The Proposed Order, in a very detailed discussion, correctly rejects Staff's proposed $4,961,0000 reduction in Peoples Gas' 2010 distribution operating expenses. ALJPO at 77-79. Staff bases its proposed adjustment on the theory that a nearly $5 million disallowance somehow is justified by the Commission's Order concerning pipeline safety and corrosion inspections in *Illinois Commerce Comm'n on its Own Motion v. The Peoples Gas Light and Coke Co.*, ICC Docket No. 06-0311 (Order Dec. 20, 2006) (the "*06-0311 Order*"). Staff takes Exception (Staff BoE at 17-29) to the Proposed Order's rejection of the adjustment, but Staff's position has no valid basis in fact or law, and its adoption would be very bad public policy.

(a) <u>Background on ICC Docket No. 06-0311</u>

On April 19, 2006, the Commission initiated ICC Docket No. 06-0311 based on a Staff report dated October 19, 2005. The Staff report arose out of Pipeline Safety record audits conducted by Staff in January 2004 and March 2005 at Peoples Gas relating to 2003 and 2004, respectively, and subsequent communications and review relating to compliance with the Pipeline Safety Act and regulations thereunder. *See Illinois Commerce Comm'n on its Own Motion v. The Peoples Gas Light and Coke Co.*, ICC Docket No. 06-0311, at 1-3 (Citation Order April 19, 2006); *see also 06-0311 Order* at 3-4.

The proceedings in ICC Docket No. 06-0311 led to a final Order, the *06-0311 Order*, in which the Commission approved a proposed settlement agreement (reflected in a joint motion and a "Stipulation") among Staff, Peoples Gas, and intervenors. *06-0311 Order* at 2, 5-9.

The "Record Evidence" section of the *06-0311 Order* is based on the testimony of Staff witness Mr. Burk in that Docket, submitted by Staff and intervenors in support of the proposed settlement agreement. *Id*. at 3-4. The Record Evidence section discusses events in 2003, 2004, and 2005 (plus one reference to 2002). *Id*. The section then concludes with this paragraph:

> In January 2006, Staff conducted an analysis of the corrosion control records maintained by Peoples. The review included a historical review of corrosion control test points that were recorded as having less than adequate levels of cathodic protection and remedial actions that had been taken. All of the test points reviewed by Staff in Peoples Gas' records indicated adequate levels of protection.

Id. at 4 (citation omitted).

The Record Evidence section is followed by a section that sets forth the proposed settlement's terms as memorialized in section 9 of the Stipulation, and then by a section in which the Commission approves the proposed settlement. *Id*. at 5-7.

Staff's proposed disallowance in the instant cases is based on Findings and Ordering paragraph 11 of the *06-0311 Order*. There, using agreed language from section 9(E) of the Stipulation, the Commission ordered, in relevant part, as follows:

> pursuant to its agreement in the Stipulation, Peoples Gas shall not seek recovery, in any future rate or reconciliation proceeding before the Commission, of costs or expenses solely attributable to Peoples Gas' not performing corrosion inspections in a timely manner, as specified in paragraph 4 above, or any incremental costs caused solely by violation of the Illinois Gas Pipeline Safety Act or its implementing regulations ("the Act") discovered by the Commission's consultant retained pursuant to the Memorandum of Understanding, and which are over and above the prudent and reasonable costs necessary to comply with the Act. Peoples Gas shall operate an internal tracking mechanism to account for any such incremental costs. ****

06-0311 Order at 8 (Findings and Ordering Paragraph 11). *See also id*. at 6 (Stipulation section 9(E)). Findings and Ordering Paragraph 11, again paralleling Stipulation section 9(E), also provided in part that Peoples Gas should not recover fees paid to the consultants retained by Peoples Gas or the Commission in connection with or as a result of the Docket. *Id*. at 6, 8.

The consultant referred to in Findings and Ordering paragraph 11 was provided for in Findings and Ordering paragraph (6) and Stipulation section 9(C). *Id*. at 5, 8. The Commission subsequently retained the Liberty Consulting Group as that consultant. Liberty's investigation began in May 2007. Burk Reb., Staff Ex. 23.0 at Attachment A, p. ES-1 and p. 2. Liberty issued its final report on August 14, 2008 (the "Liberty Report"). *Id*. at Attachment A, cover page.

(b) <u>Staff's Exception Is Unsupported and Incorrect</u>

In brief, after filing two rounds of testimony and its Initial Brief, Reply Brief, and Brief on Exceptions, Staff still is unable to cite any evidence that Peoples Gas' final revised revenue requirement in fact includes any costs barred from recovery by the *06-0311 Order*.[7] There is none, as discussed below.

In its Brief on Exceptions, Staff repeats many of its past arguments and as a result Peoples Gas incorporates all its arguments with respect to this issue in its Initial Brief (at 64-66) and Reply Brief (at 37-47). However, there are several Staff arguments that will be addressed herein.

The Proposed Order (at 77-78) correctly interprets Findings and Ordering paragraph 11 of the *06-0311 Order* to bar recovery of certain costs, specifically: (1) costs <u>solely attributable</u> to untimely corrosion inspections as specified in Paragraph 4 of the *06-0311 Order* and (2) incremental costs caused by a violation of the Illinois Gas Pipeline Safety Act ("the Act") or the regulations thereunder that are <u>over and above</u> the prudent and reasonable costs necessary to

[7] Staff and AG-CUB proposed to remove from Peoples Gas' operating expenses $540,000 for the fees of consultants related to the Liberty audit follow up work, Peoples Gas agreed, and Peoples Gas removed those costs from its proposed revenue requirement in its rebuttal testimony, so those fees are not in the utility's final revised revenue requirement and they are not a contested issue. ALJPO at 43.

comply with the Act. That follows from what the *06-0311 Order* actually says, as quoted above,[8] as opposed to Staff's characterizations.

Staff in effect continues to argue that the *06-0311 Order* should be read to include *any* costs related to the violations cited in the *06-0311 Order* and any costs related to the Liberty Audit recommendations, regardless if such costs are incurred to stay compliant with the Act. Staff BoE at 18-19. Staff's claim is wrong. Staff's characterizations are contradicted by what the *06-0311 Order* actually says, as the Proposed Order confirms. Moreover, Peoples Gas would never have agreed to the agreement that is the basis of the *06-0311 Order* if it were intended to disallow prudent and reasonable costs of compliance as Staff now contends. Schott Reb., NS-PGL Ex. JFS-2.0 at 14:253 - 15:257.

While Staff goes to great lengths to cite to Staff witness Mr. Burk's testimony and the Liberty Report in its Brief on Exceptions, Staff cites no evidence that incremental costs have been incurred under either prong of Findings and Ordering paragraph 11 of the *06-0311 Order*.

The evidence shows that there are no such costs.[9] Mr. Doerk, addressing the items that Staff witness Mr. Burk's rebuttal cited as violations based on the findings of the Liberty Audit, explained in detail why the actions taken by Peoples Gas to address Liberty's recommendations were not over and above prudent and reasonable costs necessary to comply with the Pipeline Safety Act. Doerk Sur., NS-PGL Ex. ED-3.0 at 7:135 - 10:203. Even Mr. Burk, with respect to each item he cited as a violation, agreed that Peoples Gas addressed those violations using reasonable means to comply with the Pipeline Safety Act. Burk, Tr. at 942:15 – 945:3.

[8] See *06-0311 Order* at 8 (Findings and Ordering Paragraph 11). *See also id*. at 6 (Stipulation section 9(E)).

[9] Doerk Reb., NS-PGL Ex. ED-2.0, 7:147 - 8:176; Doerk Sur., NS-PGL Ex. ED-3.0, 7:121 - 11:214; Tr. at 640:14 - 641:16; NS-PGL Init. Br. at 64-66; NS-PGL Rep. Br. at 37-47.

Mr. Burk and Mr. Doerk also agreed that the steps taken by Peoples Gas have improved its compliance with the Pipeline Safety Act. Burk, Tr. at 942:15 – 945:3; Doerk Sur., NS-PGL Ex. ED-3.0 at 8:155-159. Thus, the uncontradicted evidence is that the only costs Peoples Gas incurred arising out of the concerns raised by the Staff audits in 2004 and 2005 and the subsequent developments through the Liberty audit and thereafter were prudent and reasonable costs of complying with the Pipeline Safety Act. Burk, Tr. at 942:15 – 945:3; Doerk Reb., NS-PGL Ex. ED-2.0 at 7:153-157; Doerk Sur., NS-PGL Ex. ED-3.0 at 7:135-138.

Staff also erroneously claims that the Proposed Order reads the *06-0311 Order* too narrowly in violation of *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 171 Ill. App. 3d 948 (1st Dist. 1988) ("*BPI 1st Dist. 1988*"). Staff BoE at 22-23. Staff's reliance on *BPI 1st Dist. 1988* is misplaced. At issue in *BPI 1st Dist. 1988* was a Commission Order based on the fuel adjustment clause in Section 9-220 of the Public Utilities Act (220 ILCS 5/9-220) (formerly, Ill. Rev. Stat. 1983, ch. 111 2/3, par. 36). *BPI 1st Dist. 1988*, 171 Ill. App. 3d 948, 953. In particular, the Court states that "the statutory phrase relevant to these proceedings is 'the Commission shall initiate public hearings to determine whether the clauses reflect actual costs of fuel or power prudently purchased and to reconcile any amounts collected with actual costs.'" *Id.* at 957. With respect to that statutory language, the Court states "[t]he language of section [9-220] demonstrates a grant of broad discretion to the Commission by the legislature. … The only precise legislative directives were that the Commission hold an annual reconciliation proceeding … ." *Id.* Thus, Staff is correct that the Commission has broad discretion with respect to that statutory language.

However, the basis of Finding and Ordering paragraph 11 in the *06-0311 Order*, the paragraph on which Staff relies, is not statutory. The genesis of that language was a proposed settlement agreement entered into between Staff, Peoples Gas, and intervenors in ICC Docket No. 06-0311 that led to the *06-0311 Order*, in which the Commission approved the agreement, as discussed earlier. *06-0311 Order* at 2, 5-9. Now Staff, treading a dangerous line, wants to rewrite the terms of that agreement, to which Peoples Gas and intervenors agreed and the Commission approved, in order to support its proposed adjustment. That is not proper. Moreover, the Commission, as a matter of policy, should not endorse an approach that underlines parties' confidence in and incentive to enter into settlement agreements.

Staff also argues that the Proposed Order errs in its application of the Commission's Order in *In re Central Illinois Light Company*, ICC Docket No. 94-0040, 1994 Ill. PUC Lexis 577 (Order Dec. 12, 1994) ("*CILCO 94-0040*"). Staff BoE at 24. However, the Proposed Order application of *CILCO 94-0040* is proper. *See* NS-PGL Rep. Br. at 41-43. Further, the facts in that case are very different, and the principle that was stated and applied by both Staff and the Commission in that case (and by the Proposed Order here) supports Peoples Gas here, not Staff. *Id.* As discussed in detail in the Utilities' Reply Brief, the Commission's adoption and application in *CILCO 94-0040* of the principle that only incremental amounts due to the imprudence should be disallowed could not be clearer. For example, the Commission held: "Here, the Commission concludes that the disallowances should be imposed only to the extent that the expenses and investment exceed the levels that would have been incurred absent imprudence on the part of CILCO." *CILCO 94-0040* at *40. For all the length of its briefing of its Exception, Staff has not shown any costs that were imprudent or unreasonable, and even Mr. Burk's testimony does not support any claim to the contrary.

While failing to prove the existence of any costs that fall under either prong of the *06-0311 Order*, and perhaps recognizing the weakness of its claim, Staff indulges in rhetoric that, if the Commission were to adopt the Proposed Order's recommendation, then utilities would have no incentive to comply with Commission Orders, "in this case a requirement to track costs". Staff BoE at 17. That is a very specious claim, in multiple respects. First, the *06-0311 Order* did not require Peoples Gas to track costs that do not exist, as its plain language makes clear and as even both of Staff's witnesses on this subject confirmed. Hathhorn, Tr. at 730:4 - 731:5; NS-PGL Cross Ex. Hathhorn 24; Burk, Tr. at 942:3-14. Thus, Staff's complaint about the absence of tracking is circular, because it assumes the existence of the costs that Staff failed to prove exist and that the evidence instead shows do not exist. Second, Staff ignores that Peoples Gas already paid an agreed $1 million penalty as provided for by the agreement that is the basis of the *06-0311 Order*. *See 06-0311 Order* at 5, 7. Third, even beyond that, however, Peoples Gas takes great exception to Staff's remarkable claim about messages, because Peoples Gas' actions have proven that it has been nothing but compliant with the *06-0311 Order* and has incurred nothing but prudent and reasonable compliance costs. That is illustrated by the new hires referenced in the preceding subsection of this Reply Brief on Exceptions, and by the previous hires arising of the underlying events and the Liberty audit that are discussed by Staff witness Mr. Burk and Utilities' witness Mr. Doerk in their testimony on this subject. Finally, the reality is that Staff's arbitrary, punitive position here would punish Peoples Gas for taking prudent and reasonable steps to comply with its obligations and would send exactly the wrong message to Illinois utilities. Discouraging compliance by imposing punitive disallowances of costs to comply is not a direction that the Commission should set for Illinois utilities. Schott Reb. NS-PGL Ex. JFS-2.0 at 14:248-254.[10]

[10] Staff also does not appear to recognize that its assertion here is someone ironic given that Staff opposes essentially all of the Utilities' incentive compensation costs in these cases, including the costs associated with achieving the target level for Peoples Gas system leak reductions. Apparently, for Staff, it is all stick and no carrot.

The disallowance of prudent and reasonable costs that Staff urges here is contrary to the evidence, contrary to the *06-0311 Order*, contrary to *CILCO 94-0040*, contrary to the law governing a utility's recovery of its prudent and reasonable costs (*e.g.*, NS-PGL BoE at 4-5), and bad public policy. Therefore, for all the reasons stated herein and in the Utilities' Initial Brief and Reply Brief and herein, the Commission should reject Staff's proposed adjustment.

7. <u>Administrative & General - Injuries and Damages Expenses</u>

The Proposed Order correctly rejects Staff's proposed adjustments to "normalize" injuries and damages expenses. ALJPO at 86. The Proposed Order rejects Staff's proposal for the same reasons that the Commission rejected Staff's similar proposal to normalize injuries and damages expenses in *Peoples 2007*. Staff takes Exception. Staff BoE at 29-31.

Staff's proposal, relying on five year averages of actual claims payments for 2004 to 2008 escalated for 2009 and 2010, is to decrease injuries and damages expenses by revised figures of $864,000 as to Peoples Gas and $159,000 as to North Shore. Ostrander Reb., Staff Ex. 17.0 at Scheds. 17.2 N and 17.2 P.

Staff's Brief on Exceptions, in urging adoption of that proposal, misconceives the facts and the issues. Staff appears to argue that the very fact that choosing different normalization periods yields different results in opposite directions (discussed below) somehow supports both the premise that normalization is required and Staff's choice of a five year normalization period. Staff BoE at 29-30. Neither argument is correct.

Staff's proposal accordingly should be rejected for four reasons. First, as in the 2007 rate cases, Staff has failed to show that any "normalization" of injuries and damages expenses was required in the first place. Although the specific numbers have changed, and we deal with a future test year here, the Commission is presented with much the same evidentiary record on the subject of injuries and damages expenses as it was in the 2007 rate cases, in which it rejected Staff's proposed adjustments. The Commission there found as follows:

> **(4) Commission Analysis and Conclusion**
>
> We see from the record that depending on the time periods selected for normalizing, the results will either be fairly representative or skewed. While this Commission has accepted 5-year averaging in other cases, this is obviously not a hard and fast rule. It is always necessary, when gathering any periods of data, to further apply sound and reasoned judgment. Here, we are not persuaded by the correctness of using 5 years of data for reasons that one of these years, i.e., 2002, is clearly and unmistakably different from the others. Further, we perceive that something is inherently wrong in the selection when the results change so drastically when either 3 or 4 year data is considered. So too, we are not convinced that Staff's normalization required the complex methodology that it applied especially where plain averaging has been utilized in past cases. And, we see that the use of averaging also would have produced different results. For all these reasons, and because we are not persuaded that normalization was ever required in this instance, we reject Staff's proposed adjustments.
>
> In the final analysis, the Commission finds that North Shore and Peoples Gas used the correct levels of injuries and damages expenses in calculating their revenue requirements. North Shore appropriately used its unadjusted test year level. Peoples Gas appropriately used its test year level, adjusted for a highly unusual credit recorded in fiscal year 2006 relating to a major claim that occurred in fiscal year 2002. No adjustments need be made.

Peoples 2007 at 57.

Staff's Brief on Exceptions on this issue, remarkably, does not even mention, much less try to distinguish, *Peoples 2007*. The prior Order is not distinguishable. In the instant cases, once again, the figures and averages for the last five years (see the following table) on their face do not support normalization. Rather, they show that the amounts determined by the Utilities' forecasting process are reasonable. Gregor Reb., NS-PGL Ex. CMG-2.0 at 3:56 - 4:76.[11]

[11] The only real change on this subject from the 2007 rate cases is that the Utilities, in an attempt to narrow the issues, offered to accept Staff's revised figures for injuries and damages expenses if consistent changes to the reserves for injuries and damages in rate base also are made. *See* NS-PGL Init. Br. at 69-70 and fn. 74. Staff refused to agree, however, and the Proposed Order, finding that normalization was not warranted in the first place, accordingly did not adopt the Utilities' compromise proposal.

Actual Claims Payments Data*		
	Peoples Gas	North Shore
2004	$6,032,000	$867,000
2005	$3,250,000	$735,000
2006	$5,472,000	$541,000
2007	$4,766,000	$586,000
2008	$6,877,000	$465,000
Five Year Average for 2004 to 2008 Not Escalated for Inflation	$5,279,000	$639,000
Five Year Average for 2004 to 2008 Escalated for Inflation in 2009 and 2010 Only	$5,590,000	$676,000
Utilities' Forecasted Amounts for 2010	$6,454,000	$835,000

*All figures are from Ostrander Reb., Staff Ex. 17.0 at Sched. 17.2 N, p. 2., and Sched. 17.2 P, p. 2.

Second, Staff's decision to base its proposal on five year averages of actual claims payments for 2004 to 2008 is arbitrary, because the selected period lacks any foundation. Staff's Brief on Exceptions still offers no coherent reasons for selecting that data and the proposed period. Staff previously offered as its sole reason for selecting that data and period that the methodology of using the average of actual claim cash payments over the most recent five years to "normalize" injuries and damages expenses was approved in *In re Central Illinois Light. Co. d/b/a AmerenCILCO, et al*., ICC Docket Nos. 06-0070, 06-0071, 06-0072 Cons. (Order Nov. 21, 2006) ("*Ameren 2006*"). Ostrander Dir., Staff Ex. 3.0 at 12:239-244. That is not correct. In *Ameren 2006*, the Commission approved a methodology that used an average of actual claims payments and accruals over the most recent five years. *Ameren 2006* at pp. 48-49. Staff did not propose that methodology here. Moreover, in the 2007 cases, as quoted above, the Commission expressly recognized that, while it had used a five year period in other cases, use of a five year period "is obviously not a hard and fast rule". *Peoples 2007* at 57.

Third, Staff's approach also is arbitrary because there is no rationale for choosing the five year period over other periods that could have been selected from the same data on which Staff relied. As to Peoples Gas, had Staff chosen the most recent three year period, its methodology still would have yielded a downward adjustment but it would have been $413,000, not $864,000. *See* Ostrander Reb., Staff Ex. 17.0 at Sched. 17.2 P, p. 2.[12] As to Peoples Gas, had Staff chosen the most recent two year period, its adjustment would have been $290,000. *See id*. [13] As to North Shore, had Staff chosen three or two year periods, the adjustments would have been slightly larger. *See* Ostrander Reb., Staff Ex. 17.0 at Sched. 17.2 N, p. 2. If Staff had chosen four year periods, its proposed adjustments would have been larger for both utilities. *See id*. In the 2007 cases, the Commission, as quoted above, also found, in part: "Further, we perceive that something is inherently wrong in the selection when the results change so drastically when either 3 or 4 year data is considered." *Peoples 2007* at 57. While the variances perhaps are not as drastic here, the same conclusion still should apply. Contrary to Staff's Brief on Exceptions, the variances are not themselves a reason to normalize nor, even more to the point, to pick a five year period over any other period.

Finally, Staff's proposal, even if it had merit, should not be adopted unless consistent adjustments are made to the Utilities' reserves for injuries and damages in rate base. The Utilities presented the appropriate related adjustments to the reserves should Staff's proposal be adopted in full. Hengtgen Sur., NS-PGL Ex. JH-3.0 at 11:233 - 12:251. The Staff proposal, even if it were to have merit, which it does not, is not appropriate without those adjustments to the reserves. *Id*.; Hengtgen Reb., NS-PGL Ex. JH-2.0 at 15:329 - 16:339. Staff's Brief on Exceptions ignores this aspect of the issue. Staff's previously stated grounds for opposition to

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[12] (($5,472,000 + $4,766,000 + $6,877,000) ÷ 3) x 1.029 x 1.029 = $6,041,000, rather than Staff's five year figure of $5,590,000.

[13] (($4,766,000 + $6,877,000) ÷ 2) x 1.029 x 1.029 = $6,164,000.

making the consistent reserve adjustments were capricious. Staff took the position that the Utilities' forecasts for the injuries and damages reserves should not be modified even though Staff, based on no convincing ground and without presenting any distinction between the two, proposed to throw out the Utilities' forecasts for injuries and damages expenses. *See* Ostrander Reb., Staff Ex. 17.0 at 12:239 - 13:252. The Commission should reject Staff's Exception.

8. <u>Sales Revenue Adjustments</u>

The Proposed Order correctly rejects AG-CUB-City's proposal to adjust the Utilities' sales revenues forecasts. ALJPO at 89. AG-CUB-City nonetheless takes Exception. AG BoE at 51-52; CUB-City BoE at 5-6. Staff also now urges the adoption of the AG-CUB-City proposal (Staff BoE at 32-33), although Staff previously only expressed support for the concept but not the quantification of the proposal. The AG-CUB-City proposal is unjustified and one-sided, and it should be rejected as the Proposed Order recommends.

The AG-CUB-City proposal seeks to update the natural gas price variable, and no other variable, in the Utilities' sales models, as their witness' testimony makes clear. *E.g.*, Effron Dir., AG-CUB Ex. 1.0 at 14:290 - 15:320.[14] Updating the natural gas price variable, standing alone, when the price has decreased, results in increasing forecasted use per customer, and thus in increasing forecasted revenues under existing rates, thus altering the calculation of the revenue deficiency and thus of the charges to be set as a result of these cases. *E.g.*, Clabots Sur., NS-PGL Ex. DWC-3.0 at 1:15-21, 2:44 - 3:52.

The Proposed Order is well-reasoned and cogent in rejecting the arbitrary, results-driven AG-CUB-City proposal. The Proposed Order states:

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[14] The AG's Brief on Exceptions (at 51) indulges in literary legerdemain when stating that this updating of one variable somehow "incorporates all of the factors cited by the Company rather than isolating one". That is nonsense and false, as discussed further below.

> 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.

ALJPO at 89.

The evidentiary record amply supports the rejection of Mr. Effron's proposal, for several reasons. First, the Utilities' sales forecasts are the product of detailed, thorough forecasting methodologies conducted by, and that were supported in testimony by, experienced forecasters, Mr. Marozas and Mr. Clabots. *See* Marozas Dir., NS Ex. BMM-1.0, and PGL Ex. BMM-1.0; Clabots Dir., NS Ex. DWC-1.0 and PGL Ex. DWC-1.0. In contrast, Mr. Effron apparently has no significant training or experience, if any, as a sales forecaster. *See* Effron Dir., AG-CUB-City Ex. 1.0 at 1:9 - 2:43.

Second, Mr. Effron's proposal improperly selects one factor out of the sales models to update and ignores all other factors, including <u>the "Efficiency Improvements" group of variables, which includes the state of the economy</u>, and which uncontradicted evidence establishes is <u>more powerful than the price factor and drives down usage per customer</u>. Clabots Reb., NS-PGL Ex. DWC-2.0 at 1:15-18, 2:25 - 5:88; Clabots Sur., NS-PGL Ex. DWC-3.0 at 1:16 - 2:35. The evidence is uncontradicted that, because of timing, the economic downturn was not captured in the Utilities' sales forecasts used in their filings. Clabots NS-PGL Ex. Reb., DWC-2.0 at 2:32-39. Thus, updating all of the variables, not just a single results-driven factor, likely would result in lower sales forecasts. *Id*. at 1:17-18; *see also* Clabots, Tr. at 406.

Third, AG-CUB-City and Staff again overlook that Mr. Effron has a record of incorrectly predicting increased natural gas utilities sales and revenues. In its Order in the 2008 Nicor Gas rate case, the Commission rejected Mr. Effron's proposal to adjust upward the utility's sales forecast. The Commission noted that evidence in the record showed that his approach was less accurate than that of the utility, and that the adoption of his approach in the 2004 Nicor Gas rate case had overstated billing units, causing the utility to suffer an annual revenue loss of $5.4 million since the 2004 case. *Nicor 2008* at 187-190.

Fourth, AG-CUB-City and Staff once again overlook that the evidence is uncontradicted that Mr. Effron's proposal, if adopted, would be offset by necessary decreases in the test year revenues the Utilities forecast under their decoupling riders, reducing his adjustments to $28,000 as to North Shore and $489,000 as to Peoples Gas. Grace Sur., NS-PGL Ex. VG-3.0 at 2:39-41, 3:51-54, 21:458 - 22:487; NS-PGL Exs. VG-3.2N and VG-3.2P.

Finally, AG-CUB-City and Staff once again overlook that the evidence is uncontradicted that Mr. Effron's proposal also overlooks that, if adopted, it would require an increase in the Utilities' uncollectibles expense. Gregor Sur., NS-PGL Ex. CMG-3.0, 7:140-143.

Staff witness Ms. Harden offered rebuttal testimony supporting the concept of Mr. Effron's proposal, although not his numbers (Harden Reb., Staff Ex. 24.0 at 18:397 - 21:463), but her testimony does not provide any valid grounds for approving the proposal. She also appears to lack significant training or experience as a sales forecaster, she presented no additional grounds for the proposal, and she also overlooked all of the offsets referenced above. Clabots Sur., NS-PGL Ex. DWC-3.0 at 2:37 - 3:52.

CUB-City's Brief on Exceptions tries to rationalize the Proposed Order's rejection of Mr. Effron's proposal as exalting form over function (CUB-City BoE at 5), as if results-driven cherry-picking among the sales model variables somehow is a matter of style and not substance. Mr. Clabots' testimony referenced above disproved any such notion. CUB-City even goes so far as to suggest Order language that identifies the natural gas price variable as "the most crucial factor" and finding that there is no evidence that updating all of the variables might lead to adjustments in the opposite direction (CUB-City BoE at 6), but both of those points simply are not true, as shown above. The "Efficiency Improvements" factor that goes in the other direction in this economy is more powerful, and a comprehensive update likely would result in net adjustments in the other direction, as the uncontradicted testimony of Mr. Clabots establishes.

The AG's and Staff's Briefs on Exceptions offers only cursory discussion of this Exception. *See* AG BoE at 51-52; Staff BoE at 32-33. Their discussions adds no grounds for approval of the proposal. There are no valid grounds. The AG-CUB-City and Staff Exceptions should be rejected.

VI. Rate of Return

B. Capital Structure

The Proposed Order (at 93-94) properly concludes that the Utilities' capital structures for ratemaking purposes should not include short term debt because the Utilities do not use such debt to finance rate base assets. Although CUB-City concede that the Utilities' capital structures for ratemaking purposes should be established in accordance with "Commission precedent" and "existing Commission policy" (CUB-City BoE at 9), they persist in arguing – <u>against</u> such "precedent"[15] and policy – that the Utilities' capital structures should include short-term debt. *See* NS-PGL Reply Br. at 53-58.

[15] Commission decisions do not constitute legal precedent. *E.g., Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill. 2d 509, 513 (1953).

CUB-City assert that a 2003 Commission decision established a rebuttal presumption that "all assets, including assets in rate base, are financed in proportion to total capital." CUB-City BoE at 9, *citing Central Illinois Public Service Co. (AmerenCIPS), et al.,* Dockets 02-0798, 03-0008, 03-0009 (Cons.) (Order Oct. 23, 2003) ("*AmerenCIPS*"), at 67. As a more complete quotation from that decision shows, the Commission has established no such presumption:

> On a utility's financial statements, the total dollar value of assets must equal the total dollars of liabilities and owner's equity. <u>In a rate case, however, the total dollars of jurisdictional rate base does not necessarily equal total capitalization</u>. This is because, for example, utilities may purchase assets that are not entirely included in rate base since some assets may be used in multiple regulatory jurisdictions. As a result, for various reasons a utility's total capitalization and rate base may not be equal in amounts. Due to the fungible nature of capital, it is generally assumed that all assets, including assets in rate base, are financed in proportion to total capital. <u>However, due to certain regulatory accounting practices, short-term debt requires special attention.</u>

Id. (emphasis added).

Moreover, the Commission's decision on capital structure in *AmerenCIPS* does not support CUB-City's position. The issue in *AmerenCIPS* was not whether the utility was using short-term debt to fund rate base, but rather the reasonableness of Staff's methodology for calculating the <u>amount</u> of short term debt in the utility's capital structure for ratemaking purposes. *AmerenCIPS* at 65-68. Here, by contrast, the issue is whether any short term debt should be included in the first place. The Utilities' position that they do not use short term debt to finance rate base assets is supported by their overwhelming evidence, much of which is not contested in this record. *Compare* Johnson Reb., NS-PGL Ex. BAJ-2.0 2Rev. at 3:53 – 13:244, *with* Kight-Garlisch Reb., Staff Ex. 22.0 at 2:25 – 4:77.

For Staff's part, it only seeks modifications to the Proposed Order for the purpose of "accurately reflecting Staff's position." Staff BoE at 33. The Utilities do no object to such modifications, but Staff's proposed modifications should be limited to its position and should not disturb the ALJs' proper conclusion that the Utilities do not use short-term debt to fund rate base. The changes Staff recommends at page of 34 of its BoE should be modified as follows:

> To reduce issues in this case, Staff ~~contends that the Commission should adopt~~ did not contest the Utilities' proposed capital structure which contains no short-term debt component because it will result in a lower revenue requirement for Peoples Gas and make little difference in North Shore revenue requirements in comparison to what Staff contends is those companies' actual capital structures with short-term debt.

D. Cost of Common Equity

1. Consideration of General Financial Market Conditions

The determination of a public utility's authorized rate of return on common equity is not a mathematical game nor an exploration of *avant garde* economic theories. Public utilities must raise billions of dollars in real capital in real markets in competition with other companies, utility and non-utility, that offer investors the returns that they actually demand. If the utility's cost of equity for ratemaking purposes is to bear any relationship to its actual cost of equity, the Commission must consider the general conditions in the financial markets, especially in the wake of the worst financial crisis and economic recession since the Great Depression.

CUB-City also urge the Commission to inform itself of these conditions. To emphasize the point, their Brief on Exceptions includes (inappropriately) extra-record materials that highlight the disruptions in the equity and credit markets that have transpired since the Utilities' last rate cases, including the failure of Wall Street firms, the need for huge government bailouts to save others, the unprecedented "TARP" legislation, and the growing national unemployment rate." CUB-City BoE at 13-14. The Utilities and CUB-City could not disagree more, however, as to how these conditions (as documented by evidence that is in the record) affect the Utilities' authorized returns. The Proposed Order rejects this "debate" and chooses instead "singular[]"

reliance on the financial models upon which the Commission has "traditionally" relied. ALJPO 124-125. While CUB-City would throw the financial models out the window, save for the eccentric and extreme versions sponsored by Messrs. Bodmer and Thomas, the Utilities propose the judicious use of real world data to inform the Commission's consideration of the financial model results presented it.

In these cases, the Commission is presented with a broad array of financial model results and recommendations based on those results. For People Gas, the results are as follows:

Sponsor	**Model**	**Result**
Utilities	Risk Premium, unadjusted	12.25%
Utilities	Recommendation	11.87%
Utilities	CAPM, adjusted	11.80%
Staff	Constant DCF, unadjusted	11.76%
Utilities	Constant DCF, adjusted	11.41%
Staff	Constant DCF, adjusted	11.36%
Utilities	CAPM, unadjusted	10.86%
Utilities	Constant DCF, unadjusted	10.67%
Utilities BoE	Compromise recommendation	10.61%
ALJPO	Average, unadjusted	10.43%
Staff	Nonconstant DCF, unadjusted	10.23%
Staff	CAPM, unadjusted	9.95%
ALJPO	Average, adjusted	9.93%
Staff	Nonconstant DCF, adjusted	9.83%
Staff	Recommendation	9.69%
Staff	CAPM, adjusted	9.55%
Staff BoE	Recommendation	8.87%
CUB-City	DCF, unadjusted	8.58%
CUB-City	DCF, adjusted	8.255%

The Commission established Peoples Gas' current authorized return of 10.19% in early 2008, before the financial crisis and subsequent economic recession. Any financial model that suggests that these events have caused a reduction in the Utilities' costs of equity should be rejected out of hand. The very purpose of these models is to determine a firm's real cost of equity based on real market conditions. The undeniable reality in this case is that events since the Utilities' last rate cases have caused a general "flight of capital" from the markets, especially from more risky investments as seen by the 13% decline in investment in BBB-rated public utilities. Fetter Reb., NS-PGL Ex. SMF-1.0 at 11:219 – 12:231. Thus, even if one accepts CUB-City's position that less risky stocks like public utilities have in general suffered less than more risky ones, the Utilities' cost of capital has increased along with the rest of the market, leading Mr. Fetter to conclude that "the Utilities are sharing recessionary pressures with the entire global utility sector." Fetter Reb., NS-PGL Ex. SMF-1.0 at 9:172-174.

Mr. Moul corroborated Mr. Fetter's findings by reference to stock market volatility and yield spread data, and determined that investors require higher returns to accept the same level of risk than they did two or three years ago. Mr. Moul testified that in this investment environment, would be more difficult for the Utilities to attract equity capital at reasonable cost if the Commission lowered their authorized returns to the levels recommended by Staff or CUB-City. Moul Reb., NS-PGL Ex. PRM-2.0 Rev. at 4:67 – 7:122.

The increase in the Utilities' cost of equity since early 2008 can be seen most directly in a comparison of the Utility and Staff average return results for Peoples Gas between its last rate case and this one, assuming that Staff employed its constant growth form of the DCF model in these cases in order to provide an "apples to apples" comparison:

Sponsor	2008[16]	2010	Increase
Utilities	11.06%	11.87%	81 BP
Staff	9.70%	10.56%[17]	86 BP

Not only did the Utility and Staff results move in the same direction (increase), but they did so by a similar degree. Adding the average increase of 84 basis points to Peoples Gas' current authorized return would suggest a 2010 cost of equity of 11.03%.

A similar "apples to apples" comparison of Utility and Staff average return results for North Shore would result in an average increase of 99 basis points to North Shore's current authorized return of 9.99% to suggest a 2010 authorized return of 10.98%:

Sponsor	2008	2010	Increase
Utilities	11.06%	11.87%	81 BP
Staff	9.50%	10.66%	116 BP

With this context in mind, Mr. Fetter warned the Commission against following the recommendations of CUB-City to reduce the Utilities' authorized returns to levels not seen in Illinois since at least 1972. Such reductions in the midst of "the most challenging economic environment during the past 80 years," would be viewed by the financial markets "as a major setback" that could lead to further downgrades in the Utilities' credit ratings." Fetter Reb.,

[16] The 2008 average return results are taken from the Final Order in *Peoples 2007*. Staff's average return result includes its financial risk adjustment but not any adjustment for Rider VBA because Staff did not quantify such an adjustment in the Utilities' last rate cases.

[17] Based on an average of Staff's constant growth DCF result with its financial risk adjustment and Staff's CAPM result with its financial risk adjustment.

NS-PGL Ex. SMF-1.0 at 12:248 – 13:258; *see also* Fetter Sur., NS-PGL Ex. SMF-2.0 at 9:189-194. Such downgrades would be major setbacks for the Utilities (and their customers), as the cost of debt capital for BBB-rated public utilities has increased dramatically since the financial crisis. Fetter Reb., NS-PGL Ex. SMF-1.0 at 17:358 – 19:383.

In this context, the Commission should establish authorized returns that are within the mainstream of recent authorized returns, that will enable the Utilities to maintain their current split A/BBB credit ratings, and that will ensure that the Utilities have ready access to capital at reasonable cost as the financial markets recover. Fetter, Tr. at 502 - 516. As shown above, the comparable average return results of the Utilities and Staff uniformly support a significant increase in the Utilities' authorized returns. The mid-point of recent authorized returns is in the mid-10% range, which is substantially higher than the Utilities' current authorized returns. Fetter Reb., NS-PGL Ex. SMF-1.0 at 7. As shown above, the mid-point of the parties' financial model returns and recommendations is also in the mid-10% range.

Considered in this context, only the Utilities' proposed authorized returns –as proposed originally and as proposed in their compromise proposal on exception – are consistent with both the general market trend of increasing capital costs and the specific evidence of the Utilities' increased equity costs. Staff's and CUB-City's recommendations to reduce the Utilities' returns to unprecedented levels are simply not credible.

2. <u>DCF Analyses</u>

In their prior briefs, the Utilities explained that Staff and the Commission have historically relied on the "constant growth" or "single stage" form of the DCF model, including in the Utilities' last rate cases. However, shortly after the Utilities' last rate cases, Staff switched to the "non-constant" or "multi-stage" form of the model and Staff's new methodology has been accepted by the Commission without comment (or, apparently, opposition) since.

Staff's claimed reason for its sudden shift, that analyst earnings growth rates for natural gas utilities are higher than the growth of the overall economy, is nothing new and is not a valid reason for the change. Tr. 528:22 – 530:12. The more plausible explanation for Staff's switch is that Staff could not abide the results of its own constant growth DCF model (11.76% in these cases) and substituted the non-constant form of the model in order to suppress the Utilities' costs of equity. NS-PGL Init. Br. at 87-92; NS-PGL Reply Br. at 63-64; NS-PGL BoE at 41-43.

The Proposed Order adopts a middle ground, accepting the unadjusted DCF results of both the Utilities and Staff despite their disputes over the proper form of the model and the use of historical and "spot day" information. ALJPO at 125-127. In their Brief on Exceptions, the Utilities urged the Commission to reject Staff's DCF result because Staff failed to justify its switch to the non-constant form of the model. NS-PGL BoE at 43. In its Brief on Exceptions, Staff claims that the non-constant form is the <u>only</u> form of the DCF model that <u>can</u> be used to set the Utilities' cost of equity. Staff BoE at 34-40. As shown below, the record does not support Staff's position on Exceptions.

First of all, Staff has not demonstrated that the current growth rate of the Gas Group is unsustainable, much less so high as to justify the application of the non-constant growth form of the DCF model. Objective sources, including a leading Federal Energy Regulatory Commission ("FERC") decision, confirm that the non-constant growth form of the DCF model is appropriate only when a firm's near-term earnings growth is extraordinarily high and the reasons for that growth spike are temporary, such that the analyst can expect, based on firm-specific information, that the firm's growth will slow in the future. Moul Reb., NS-PGL Ex. PRM-2.0 Rev. at 18:362

– 19:381. Staff failed to demonstrate that either of those prerequisites apply to the Utilities; indeed, Staff did not even try.

Staff's argument that the Gas Group's near-term growth rate is "40% faster than that of the overall economy" (Staff BoE at 35) is misguided because the third stage of non-constant form of the model is not tied to growth of the overall economy, but to the long-term earnings growth of the firm being analyzed. Moreover, GDP growth is not an appropriate measure of long-term earnings growth. NS-PGL Init. Br. at 91. Even if the relationship between the Gas Group's growth rate and GDP growth was relevant, Staff is simply wrong in asserting that it is mathematically impossible for the growth rate of one component of the GDP to exceed the GDP growth rate in the long run. To the contrary, the GDP growth rate is an average of the growth rates of all of its components, some of which are higher and some of which are lower than the average. NS-PGL BoE at 38. Thus, any relationship between Staff's proposed third-stage growth rate and GDP (Staff Reply Br. at 36-37) is irrelevant.

Moreover, Mr. McNally never proved that his second and third stage growth rates were relevant to the stock prices that he employed for the Gas Group. The first stage is a period of "rapidly expanding markets, high profit margins and abnormally high growth in earnings per share." Moul Dir., PGL Ex. PRM-1.0 Rev. at 16:334-336.[18] Mr. McNally made no effort to show that analyst growth rates for the Gas Group have any of these characteristics. Nor did he show that his second-stage growth rate reflects the characteristics of a "transition" period for the Gas Group "where fewer technological advances and increased product saturation begin to reduce the growth rate and profit margins come under pressure." *Id.* at 16:336-338. To the contrary, Mr. McNally's second stage growth rate is simply an average of his first and third stage

[18] Staff has endorsed Mr. Moul's characterization of the three stages of growth. Staff BoE at 36 fn. 6.

growth rates. McNally Dir., Staff Ex. 7.0R, at 7:137-138. Finally, Mr. McNally failed to demonstrate how his third-stage growth rate for the Gas Group contains characteristics of a "steady-state" period where "a firm's earnings growth, payout ratio, and return on equity stabilizes at levels where they remain for the life of a firm." Moul Dir., PGL Ex. PRM-1.0 Rev. at 16:341-343.

Staff argues, without citation to the record, that investors cannot expect "the companies in the Gas Group to sustain above-average growth given their below-average earnings retention rates and below-average risk and return, <u>both of which are indicators of below-average growth</u>." Staff BoE at 35 (emphasis added). Putting aside whether the record supports Staff's argument, Staff proves the Utilities' point. If investors expect the Gas Group companies to achieve below-average growth, then current analyst earnings growth rates for those companies presumably reflect that expectation. Also, if the Gas Group's financial parameters are indeed indicative of below-average growth, then it is inappropriate to apply the multi-stage form of the DCF model to them.

Finally, Staff claims, again without citation to the record, that "Mr. McNally concluded that the potential measurement error of his NDDCF analysis is less significant than the certain measurement error arising from the application of current unsustainable growth rates in a constant growth DCF model." Staff BoE at 37. No such conclusion by Mr. McNally is of record, and Staff's claim is therefore improper. Even if Mr. McNally held this opinion, though, the record does not sustain it. As discussed above, Mr. McNally did not support his opinion that current Gas Group growth rates are unsustainable. Moreover, there is no evidence that Mr. McNally considered, much less analyzed, the degree of potential error in the growth rates he assigned to the second and third stages in his multi-stage model. Because those rates are not linked to company-specific performance among the companies in the Gas Group, they are entirely speculative when matched with the actual stock prices of the companies in the Gas Group. For these reasons, the Proposed Order properly characterizes Mr. McNally's non-constant growth model as more prone to measurement error.

In sum, Staff has not engaged in the analysis required (and actually employed by FERC) to show that the Utilities and the companies in the Gas Group display the characteristics that warrant a multi-stage growth approach. Nor has Staff shown that the three growth rates it used in its multi-stage model would fit those characteristics. Instead, Staff simply asserts that the multi-stage model is appropriate whenever it can claim that near-term analyst growth rates are too high to be sustainable in the long run. As designed and applied, the multi-stage DCF model requires a more robust and nuanced showing than Staff's wild swing at the pitch.

In light of these facts, the Utilities maintain their position that the Commission should disregard Staff's DCF result in these cases, and propose the following revised changes to the Proposed Order's discussion and conclusions regarding DCF analyses (the following are modified versions of the Utilities' Exception Nos. 11 and 14 from their November 24, 2009, filing):

<u>The Companies' DCF Analysis</u>

<u>EXCEPTION NO. 11</u>

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Based on objective sources, including academics cited by Staff and the Federal Energy Regulatory Commission ("FERC"), the Utilities argue that the constant growth DCF model is appropriately applied to natural gas utilities like the Utilities because their growth rates are not significantly higher than GDP growth, much less the two to three times GDP growth that FERC uses as one of its criteria for determining whether to apply the non-constant growth form of the model. Based on these objective criteria, which clearly call for the application of the constant growth DCF model to the Utilities, <u>and Mr. McNally's failure to show, or even analyze, that his</u>

growth rates in his multi-stage model met the required characteristics, Mr. Moul concluded that Staff's decision to switch to a non-constant form of the model reflects a subjective decision by Staff to reach lower cost of equity results. Indeed, Mr. Moul calculated the Utilities' cost of equity using Staff's constant growth DCF model and the result was 11.76%, which is over 150 basis points over Staff's non-constant growth DCF result of 10.23% and is comparable to Mr. Moul's adjusted constant growth DCF result of 11.41%. Finally, the Utilities note that the Commission included Mr. Moul's constant growth DCF model as among the cost of equity analyses that formed "an appropriate basis to determine ROE" in their last rate cases.

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The DCF Analyses

EXCEPTION NO. 14

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~~We find reasons for Staff's switch to the non-constant growth, at least in this case, in the testimony of Mr. McNally.~~ In contrast to the constant growth version of the DCF model which assumes one, steady rate of future price growth (and which the Utilities deem~~s~~ appropriate to their being in business for decades), Staff's non-constant growth model assumes multiple stages of growth on the theory that given the ~~large~~ difference between the near-term growth rates for the Gas Group and the overall growth of the economy, the continuous sustainability of the near-term growth rates for the gas group is unlikely. Staff failed, however, to demonstrate the unsustainability of the analyst growth rates it relied on, which we must assume took into account indicators of below average growth associated with the Gas Group, including earnings retention rates and risk/return.

Together with this explanation, however, the Commission notes the testimony of Mr. McNally to have described the multiple-stage non-constant model as being a far more elaborate model. As he describes it, this model has additional unobservable growth rate variables that are likely subject to greater measurement error than the analyst growth rate estimates that Staff uses for its constant–growth analysis. Although Staff asserted on exception that Mr. McNally concluded that the measurement error associated with the constant model was higher than that with the non-constant model in this case, we find no evidence to support Mr. McNally's conclusion, particularly with respect to the growth rates he selected for the second and third stages of his multi-stage model. We are also mindful of the Utilities' arguments that Staff did not prove that the Utilities or the Gas Group have characteristics that would justify application of a multi-stage model, did not demonstrate that its growth rates in the second and third stages of its model met the applicable characteristics, and did not adequately support its use of the GDP growth rate for the long-term growth rate in the non-constant model or its calculation of the GDP rate itself. In any event, ~~U~~under this model, Staff witness McNally produced a DCF result of 10.23 %.

We find that the reasons for Staff's switch to the non-constant growth version of the DCF model require additional inquiry. After consideration of the academic literature presented us, as well as FERC's treatment of the issue, ~~the difference between the rates in this case do not appear to be large enough to compel the use of the non-constant growth form of the model to the exclusion of the constant growth form upon which we have historically relied.~~ we reject Staff's position that the non-constant growth form of the model must be used any time it can be claimed that analyst growth rates are not sustainable. Rather, we will require a more robust showing that application of the constant model is appropriate.

. . .

3. CAPM Analyses

The determination of a utility's cost of equity involves as much art as science. McNally, Tr. at 696:11-14. Given its reliance on complex economic models that are designed to determine a firm's actual market cost of equity based on formulae that depend on the accuracy of the data input to them, the exercise is susceptible to manipulation. Whether art or science, however, the result must square with reality. As the Utilities said at the outset, this is not a mathematical game of strategic manipulation; it is an effort to discover, for regulatory purposes, what return on equity real investors really require.

In these cases, however, Staff regrettably takes gamesmanship to a new level by arguing in its BoE for returns that are lower than its own witness recommended. Staff does this by, first, arguing that Mr. Moul's CAPM result should not be considered (Staff BoE at 41) and, second, that the Commission should construct a new CAPM model of its own with a carefully selected combination of inputs used by Mr. Moul and Mr. McNally (*id.* at 41-42). By no coincidence, this new CAPM result (9.60%) – supported by no witness – is lower than the CAPM result that Staff's own expert sponsored (9.95%). Staff's Brief on Exceptions then factors in this newly manufactured CAPM result with its own DCF result (10.23%). That math generates a market cost of equity for the Utilities (9.92%) that is lower than Mr. McNally's result (10.09%). After Staff's proposed adjustments for financial risk and riders are tacked on, Staff's new cost of equity recommendations are 9.42% for North Shore (compared to Mr. McNally's recommendation of 9.50%) and a mere 8.87% for Peoples Gas (compared to Mr. McNally's recommendation of 9.70%). Staff's new returns are significantly lower than any return this Commission has set for a natural gas utility in at least the last 40 years.

As far as the Utilities can tell from reviewing past decisions and briefs, this is the first time in at least the last 10 years, if not ever, that a party in a rate case has waited until its brief on exceptions to abandon its position on cost of equity for a new and even more aggressive one. Neither Staff's new CAPM model nor its new cost of equity positions were endorsed by any witness in this proceeding. Rather, Staff has picked and chosen among various Utility and Staff inputs to come up with an entirely new and significantly more aggressive financial model result and cost of equity recommendation. Staff's new position is the product of a highly partisan, result-driven manipulation of the financial models presented by the Utility and Staff experts.

The Commission should reject Staff's new position and approach. Two (or more) could play Staff's game and the result would be predictable. For example, instead of using Mr. McNally's beta estimate in the new calculation, as Staff does, we could use the *Value Line* beta of 0.69 and combine that with the average Utility-Staff risk premium of 9.195% and the average Utility-Staff risk free rate of 4.175%. The result would be a cost of equity of 10.52% (4.175 + (0.69 x 9.195) = 10.52). Or we could take Mr. McNally's market risk premium and risk free rate and combine them with Mr. Moul's updated beta of 0.78 to get 11.98% (4.25 + (0.78 x 9.91) = 11.98). It is a very simple game.

As the Utilities show below, Staff's stated reasons for changing its position at the last minute are baseless and pretextual. When coupled with its still-to-be-explained conversion from the constant to the non-constant form of the DCF model, Staff's latest move suggests a "no holds barred" approach that will reduce the sworn opinion of experts (even Staff's) to mere building blocks for positions to be created later in briefs. This approach will increase divisiveness and make the Commission's job far more difficult than it is already. The susceptibility of cost of equity analyses to such gamesmanship underscores the necessity for the Commission to evaluate the partisan positions taken in rate cases – including Staff's increasingly aggressive approach – against general financial market conditions. Staff's new CAPM result takes Staff's recommendation further in the opposite direction of general utility market capital costs, and to a level that has no credibility in the real world, much less in the record in the form of the results and recommendations sworn to by Staff's cost of equity expert, or any other witness in this proceeding.

In short, the Commission should forcefully reject Staff's attempt to introduce a new financial model result and new, more aggressive positions on cost of equity in its Brief on Exceptions to a Proposed Order.

a. "Appropriate" Beta Weighting

Staff's first pretext for changing its cost of equity position at this late date is that the Proposed Order gives undue "weight" to *Value Line* betas by accepting the Utilities' and Staff's CAPM results. The only support for this assertion is that Mr. McNally relied on two other betas in addition to a *Value Line* beta and the claim that "none of the methodologies used by those three sources is inherently superior to the others." Staff BoE at 40.

The Utilities question whether the "weighting" of any given parameter that may result whenever the Commission accepts multiple financial model results is even relevant. At least implicitly, the Proposed Order recognizes and accounts for what seems to be Staff's main point, that because the beta is an "unknowable" parameter different analysts can have differing yet reasonable opinions. In this case, the ALJs properly concluded that the relative proximity of the betas used by Mr. Moul and Mr. McNally, however they arrived at them, was a factor supporting the reasonableness of accepting both of their CAPM results.

Nonetheless, Staff's post hoc position that the ALJs' approach places too much weight on *Value Line* finds no support in the record. Staff's citation of Mr. McNally's testimony for the proposition that none of the three beta methodologies relied on by the Utilities and Staff "is inherently superior to the others" is a stretch at best. Staff BoE at 40. In his rebuttal, Mr. McNally testified that the *Value Line* methodology "is not inherently superior" to Staff's methodology. McNally Reb., Staff Ex. 21.0 at 17:389-390. At hearing, Mr. McNally gave his opinion that there is no "right" or "wrong" beta. Tr. 687-689. At no time did Mr. McNally provide an opinion as to Zacks' beta methodology. Nor could he have, as *Value Line* is the only published beta source that also publishes its methodology. Tr. 461-464.[19]

If Staff was correct, it would create a fundamental flaw in Staff's CAPM model. If no beta estimate is any better than any other one, then Mr. McNally's limitation of his beta calculation to *Value Line, Zacks* and his own beta give undue weight to those three

[19] As discussed below, there is no record basis for Staff's assertion that the Zacks publishes its methodology, and Mr. McNally provided only a partial description of it in his testimony.

methodologies over others. Staff fails to explain why its weighting of beta methodologies is any more "appropriate" than the weighting that results from the ALJs' methodology, much less Mr. Moul's exclusive reliance on *Value Line*, which is universally consulted in public utility rate cases. Tr. 462.

If there is no "right" or "wrong" beta, as Staff claims, then there is certainly no "right" or "wrong" weighting of the various betas. If it is relevant at all, the fact that the ALJs' acceptance of the Utilities' and Staff's CAPM results can be interpreted as a 75% "weighting" of *Value Line* betas is more than adequately supported by the transparency of *Value Line's* methodology and the broad reliance on *Value Line* in the industry. By contrast, Staff's position that its beta "assigns an appropriate weight" to *Value Line* is an empty assertion made to serve as a pretext for Staff's post-hearing manipulation of the CAPM model.

b. <u>The Unadjusted Updated Utility CAPM</u>

Staff's second pretext for presenting a newly devised CAPM result is that the Utilities' updated CAPM result accepted in the Proposed Order reflects Mr. Moul's leverage adjustment to the beta, which the Proposed Order elsewhere rejects, and that there is no record basis for removing that adjustment to get to an unadjusted version of the Utilities' updated CAPM result. Staff BoE at 41. The formulation of Mr. Moul's updated beta is not in the record, but Staff knows what it is because it is contained in Mr. Moul's workpapers filed with his rebuttal testimony.[20] If Staff truly had an issue with how Mr. Moul updated his beta, Staff had every

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[20] Staff also knows that Mr. Moul's updated unadjusted average *Value Line* beta for the Gas Group is just three basis points lower than his original unadjusted beta of 0.69, the beta that is reflected in the Proposed Order. ALJPO at 127. Staff also knows that if this beta was used in Mr. Moul's CAPM calculation, the result would be 10.79%, just seven basis points lower than the 10.86% result accepted in the Proposed Order. Staff's challenge to Mr. Moul's updated beta is the quintessential "red herring."

opportunity to make a record on it.[21] Indeed, should Staff wish the Commission to have this data in the record, the Utilities would not object even now to a motion by Staff to offer it into evidence. But, having not done so, it is inappropriate for Staff to base exceptions to the Proposed Order on matters not of record.

c. Published Beta Methodologies

Staff's third pretext takes exception to the Proposed Order's reliance on Mr. Moul's undisputed testimony that *Value Line* is the only published source of betas that publishes its methodology. Staff goes so far to assert that this is a "demonstrably false claim." Staff BoE at 42. But Staff fails to prove its assertion. Although Mr. McNally may have "testified to" a certain aspect of Zacks methodology (McNally Dir., Staff Ex. 7.0R at 18:346-350), nowhere does he or anyone else contest Mr. Moul's testimony that only *Value Line* publishes its methodology. Indeed, the record is void of even the source of Mr. McNally's understanding of the single aspect of Zacks' methodology that he identified. For these reasons, Staff's argument itself is a "demonstrably false claim" and Staff's proposed changes to the Proposed Order on this point must be rejected.

d. Staff's Reliance on Historical Data

After taking the position throughout these cases that the Utilities' cost of equity analyses are flawed because they rely in part on historical data, Staff's proposes to average its market premium with the Utilities' updated market premium, which is based in part on historical data. Mr. Moul's original and updated market premiums were calculated as a simple average of forecast and historical returns. Moul Dir., PGL Ex. PRM-1.0 Rev. at 38:820 – 40:849. If Staff

[21] If Staff or the Commission desires, the Utilities would have no objection to the relevant work papers, WP-PRM-1 and WP-PRM-7, being made part of the record.

was consistent, it would have to rely on an equal weighting of Staff's "current" premium with the Utilities' forecast premium, which is not of record but is available in Mr. Moul's workpapers. Otherwise, Staff is having it both ways by attacking Mr. Moul's use of historical data and at the same time sponsoring a new CAPM that incorporates a market risk premium that is based in large part on historical data.

e. Accepted CAPM Results

Staff has abandoned its own witness's CAPM analysis in favor of a CAPM model that inappropriately mixes Utility and Staff inputs in a way no witness supports to arrive at a result that, if factored into other results that Mr. McNally actually sponsored, yields lower cost of equity positions than Mr. McNally supported. The Commission should not countenance such manipulation of the financial models on which the Commission has traditionally relied. The Commission should forcefully reject Staff's blatant results-driven manipulation of the CAPM. And, because Staff has abandoned Mr. McNally's CAPM result, the Commission should accept only the Utilities' CAPM result.

Accordingly, the Utilities propose the following updated changes to the Proposed Order, which supersede the changes proposed in the Utilities brief on Exceptions (the following is a modified version of the Utilities' Exception No. 12 from their November 24, 2009, filing):

The Companies' CAPM Analysis

EXCEPTION NO. 12

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Mr. Moul challenged Mr. McNally's reliance on ~~90-day Treasury bills for the risk-free rate, noting that the one-day, spot rate Mr. McNally used was 0.10%, or almost zero, as a result of the financial crisis. Finding that the risk-free rate could not be essentially zero, Mr. Moul reasonably relied on~~ a spot quote for 30-year Treasury bonds for the risk free rate instead of *Blue Chip* forecasts, noting that if Mr. McNally had selected a date just three weeks later his risk free rate and would have been higher. Indeed, using a reasonable forecast of 30-year Treasury bonds with Staff's CAPM yields an ROE of 10.52% instead of the 9.95% Staff obtained with the one-day spot quote. NS-PGL Ex. PRM-2.0 Rev. at 24-25.

The Utilities strongly object to Staff's new and lower CAPM model result presented in its brief on exceptions. Having reviewed rate case decisions and briefs over the last 10 years, the Utilities believe that this is the first time any party has waited until this late stage of the proceedings to abandon its position on cost of equity for a more aggressive one. Rather than supporting the Commission's acceptance of the model result of Staff's cost of equity witness, Staff proposes that the Commission pick and choose among the inputs used by the cost of equity witnesses of the Utilities and Staff to derive a CAPM estimate that no witness sponsored. By no coincidence, the inputs selected by Staff result in a CAPM estimate that is significantly lower than the CAPM result of Staff's own witness. The Utilities urge us to reject such results-driven manipulation of the cost of equity models, arguing that acceptance of Staff's approach would reduce the importance of expert opinion and increase the divisiveness and difficulty of rate case proceedings.

. . .

The CAPM Analyses

. . .

After imputing all three parameters into the CAPM, Mr. McNally calculated a cost of equity estimate of 9.95% for the Gas Group. The unadjusted CAPM result that Mr. Moul arrived at from all three parameters is 10.86%. The estimate that Mr. Thomas recommends is the range of 5.85% - 7.12%. Given the disparity between Mr. Thomas' estimate and the results produced by Staff and the Utilities, we will not consider CUB-City's estimate.

On exception, Staff presents a new and lower CAPM result based on selected inputs from Mr. Moul and Mr. McNally. We find Staff's reasons for doing so to be baseless and pretextual, and we reject this unprecedented attempt by Staff to change its position for the worse far too late in the proceeding. Staff position that our acceptance of the CAPM results of Mr. Moul and Mr. McNally would place "undue weight" on the *Value Line* beta is void of logic or any limiting principle by which we could arrive at the proper "weighting" of betas. Given the proximity of Mr. Moul's updated CAPM result with Mr. McNally's we find it unnecessary to inquire into the underlying beta for that result. We are also troubled by Staff's apparent selection of inputs to its new CAPM without regard to whether the inputs are consistent with its own witness' approach. Even if we could find a facially acceptable rationale for Staff's approach, we find the approach itself objectionable. It is simply inappropriate for a party to wait until exceptions to present a new and more aggressive cost of equity estimate that no witness in the proceeding supported. We share the Utilities' concerns about the degradation of the quality of the discourse in this highly technical and complex area, and the amount of additional effort it would likely generate. Understanding Staff to have abandoned Mr. McNally's CAPM result in favor of the improper one that we reject,

[Alternatives 1 (The Commission accepts the Utilities' proposed 11.87% ROE) and 2 (The Commission accepts the Utilities' compromise proposal.]

Understanding Staff to have abandoned Mr. McNally's CAPM result in favor of its new one, which we reject, ~~T~~this leaves ~~both the Staff and~~ only the Utilities estimate~~s~~ for the Commission to review. We find ~~both of their applications~~ only the Utilities' estimate to be reasonable. ~~And, neither shows itself to be superior.~~ ~~Staff's result of 9.95% is too far outside of the mainstream for reasonable consideration.~~ ~~Thus, we will consider the estimates of both Mr. McNally and Mr. Moul in our final calculation.~~

~~***[Alternative 2: The Commission accepts the Utilities' compromise proposal.] (unchanged)***~~

~~This leaves both the Staff and the Utilities estimates for the Commission to review. We find both of their applications to be reasonable. And, neither shows itself to be superior. Thus, we will consider the estimates of both Mr. McNally and Mr. Moul in our final calculation.~~

. . .

4. Staff's Rider UEA Adjustment

Staff urges the Commission to increase any adjustment it makes to the Utilities' cost of equity for Rider UEA, arguing without citation to the record that its own analysis underlying the 10-basis-point adjustment adopted by the Proposed Order is sub-optimal. Staff's position is again not supported by the record. Certainly Mr. McNally expressed no such opinion. Rather, he presented three "approaches," a range of adjustments for each Utility, and then simply recommended an adjustment for each Utility that was the midpoint of the applicable range. McNally Dir., Staff Ex. 7.0R at 30:576 – 34:671. There is no support for the assertion in Staff's brief that "in determining the required rate of return on common equity, investors would assess such a rider's effect on a company-specific basis." Staff BoE at 45. The Commission should therefore ignore Staff's newly created argument.

Staff also asserts that Section 19-145 of the Act provides "little incentive for the [U]tilities to be persistent" in recovering bad debt, and that cost of equity adjustments such as those it proposes in these cases would provide the appropriate incentive. These assertions are false. The statute requires annual prudency reviews, which will provide Staff and the Commission ample opportunity to review and, if necessary, take actions to correct the Utilities' collection methods and efforts. 220 ILCS 5/19-145(c). In particular, the statute requires the Commission to "review the prudence and reasonableness of the utility's actions to pursue minimization and collection of uncollectibles." *Id.* In such a prudence review, the statute empowers the Commission to "determine any required adjustments and may include suggestions for prospective changes in current practices." *Id.* Moreover, the statute places an affirmative obligation on gas utilities to pursue collection, including but not limited to six enumerated activities. *Id.* Staff fails to explain why it would make any practical business sense for the Utilities to be lackadaisical about collections, when every dollar collected is a dollar collected whereas any dollar sought to be recovered through Rider UEA is subject to disallowance in a prudence review.

Properly understood, Section 19-145 of the Act prescribes the incentives and obligations placed on a gas utility that avails itself of an uncollectible rider like Rider UEA. Staff's proposed cost of equity adjustment would violate the statute by imposing an additional incentive and obligation on the Utilities. Section 19-145 is crystal clear in its prescriptions. As an administrative agency, the Commission may not "expand the scope of a piece of legislation to include requirements not found in the statute." *Pierce Downer's Heritage Alliance v. Village of Downer's Grove*, 302 Ill. App. 3d 286, 298-299 (2d Dist. 1998). It must follow and implement a statute's plain language "irrespective of its opinion regarding the desirability of the results surrounding the operation of the statute." *In re Illinois Bell Tel. Co.*, ICC Docket No. 01-0614 (Interim Order on Remand (Phase I), April 20, 2005), at 47.

Aside from its legal infirmities, Staff's idea of a cost of equity adjustment as an "incentive" for utility collection efforts is too poorly developed to merit serious consideration. Simply adjusting the Utilities' authorized returns in these rate cases would provide no incentive whatsoever. To the contrary, it would impose a disincentive against implementing an uncollectible rider. The only way than a cost of equity adjustment in these rate cases would provide a collection incentive would be if the Commission also established a system of "subsequent adjustments for uncollectibles riders [that] would be inversely related to the proportion of collections the Companies make directly, rather than through their uncollectibles riders." Staff BoE at 46. The Utilities assume that any such system would include upside "reward" adjustments as well as downside "risk" adjustments to provide the desired incentive. Yet Staff's proposal is devoid of a proposal for a system, but less a serious and detailed analysis on one. As it stands, Staff simply wants an adjustment made now for the sake of suppressing the Utilities' costs of equity, with no provision for adjustments in the future that would create the incentive.

For these reasons, the Commission should reject Staff's proposed adjustment for Rider UEA in its entirety. Alternatively, the Utilities are willing to abide by their compromise proposal for the Commission to accept the Proposed Order's 10-basis-point adjustment for

Rider UEA if the Commission rejects Staff's proposed financial risk adjustment (Alternative 2A).

5. Cost of Equity Summary

In light of Staff's abandonment of its expert's CAPM result and the inappropriateness of Staff's new CAPM result, the "Final Conclusions" of Section VI of the Proposed Order should be revised as follows (the following is a modified version of the Utilities' Exception No. 16 from their November 24, 2009, filing):

EXCEPTION NO. 16

[Alternative 1: The Commission accepts the Utilities' proposed ROE.]

Final Conclusions

In the final analysis, the calculation of ROE in these cases will be affect by the following conclusions:

(1) the DCF estimate~~s~~ of ~~both Staff and~~ the Utilities will be included in this calculation;
(2) the CAPM analyse~~s~~ of ~~both Staff and~~ the Utilities will be included in this calculation;
(3) the Utilities' financial leverage adjustment is ~~rejected~~ accepted;
(4) Staff's financial risk adjustment is ~~accepted~~ rejected;
(5) Staff's 10 basis point adjustment for Rider VBA is rejected~~accepted~~;
(6) A 10 basis point adjustment for Rider UEA, which represents the lower end of Staff's adjustment range, is ~~accepted~~ rejected;
(7) Staff's 163 basis point adjustment, applicable only to Rider ICR is ~~approved~~ rejected.

Based on these conclusions, the resulting ROE for both Utilities is 11.87%. We evaluate this level of return in the general financial market context with which we began this discussion, and find that this level of return is in the range of recent authorized returns and reflect increases in the Utilities' cost of equity, which is consistent with the general increase in capital costs that has resulted from the economic recession.

E. Weighted Average Cost of Capital

1. North Shore

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for North Shore Gas of ~~8.028~~ 9.058%, calculated as follows:

	Percent of Total Capital	Cost	Weighted Cost
Long Term Debt	44.00%	5.48%	2.411%
Common Equity	56.00%	~~10.03%~~ 11.87%	~~5.617%~~ 6.647%
Total Capital	100.00%		
Weighted Average Cost of Capital		~~8.028%~~9.058%	

2. Peoples Gas

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for Peoples Gas of ~~7.884~~ 8.970% calculated as follows:

	Percent of Total Capital	Cost	Weighted Cost
Long Term Debt	44.00%	5.28%	2.~~411~~323%
Common Equity	56.00%	~~9.93%~~ 11.87%	~~5.561%~~ 6.647%
Total Capital	100.00%		
Weighted Average Cost of Capital			~~7.884%~~8.970%

[Alternative 2A: The Commission rejects Staff's financial adjustment and accepts Staff's rider adjustments.]

Final Conclusions

In the final analysis, the calculation of ROE in these cases will be affect by the following conclusions:

(1) an average of the constant growth DCF estimates of both Staff and the Utilities will be included in this calculation;
(2) ~~an average of~~ the CAPM analyseis of ~~both Staff and~~ the Utilities will be included in this calculation;
(3) the Utilities' financial leverage adjustment is rejected;

(4) Staff's financial risk adjustment is ~~accepted~~ rejected;
(5) Staff's 10 basis point adjustment for Rider VBA is accepted;
(6) A 10 basis point adjustment for Rider UEA, which represents the lower end of Staff's adjustment range, is accepted;
(7) Staff's 163 basis point adjustment, applicable only to Rider ICR is approved.

Based on these conclusions, the resulting ROE for both Utilities is 10.~~61~~84%. We evaluate this level of return in the general financial market context with which we began this discussion, and find that this level of return is in the mid-range of recent authorized returns and reflect small increases in the Utilities' cost of equity, which is consistent with the general increase in capital costs that has resulted from the economic recession.

E. Weighted Average Cost of Capital

1. North Shore

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for North Shore Gas of ~~8.028~~ 8.~~353~~481%, calculated as follows:

	Percent of Total Capital	Cost	Weighted Cost
Long Term Debt	44.00%	5.48%	2.411%
Common Equity	56.00%	~~10.03%~~ 10.~~61~~84%	~~5.617%~~ ~~5.942~~ 6.070%
Total Capital	100.00%		

Weighted Average Cost of Capital ~~8.028%~~8.~~353~~481%

2. Peoples Gas

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for Peoples Gas of ~~7.884~~ 8.~~265~~393% calculated as follows:

	Percent of Total Capital	Cost	Weighted Cost
Long Term Debt	44.00%	5.28%	2.~~411~~323%
Common Equity	56.00%	~~9.93%~~	~~5.561%~~

		10.~~61~~84%	~~5.942~~ 6.070%
Total Capital	100.00%		

Weighted Average Cost of Capital	~~7.884%~~8.~~265~~393%

[Alternative 2B: The Commission accepts Staff's financial risk adjustment and rejects Staff's rider adjustments.]

Final Conclusions

In the final analysis, the calculation of ROE in these cases will be affect by the following conclusions:

(1) an average of the constant growth DCF estimates of both Staff and the Utilities will be included in this calculation;
(2) ~~an average of~~ the CAPM analys~~e~~is of ~~both Staff and~~ the Utilities will be included in this calculation;
(3) the Utilities' financial leverage adjustment is rejected;
(4) Staff's financial risk adjustment is accepted;
(5) Staff's 10 basis point adjustment for Rider VBA is ~~accepted~~ rejected;
(6) A 10 basis point adjustment for Rider UEA, which represents the lower end of Staff's adjustment range, is ~~accepted~~ rejected;
(7) Staff's 163 basis point adjustment, applicable only to Rider ICR is ~~approved~~ rejected.

Based on these conclusions, the resulting ROEs are 10.~~51~~74% for Peoples Gas and 10.~~61~~84% for North Shore. We evaluate these returns in the general financial market context with which we began this discussion, and find that this level of return is in the mid-range of recent authorized returns and reflect small increases in the Utilities' cost of equity, which is consistent with the general increase in capital costs that has resulted from the economic recession.

E. Weighted Average Cost of Capital

1. North Shore

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for North Shore Gas of ~~8.028~~ 8.~~353~~481%, calculated as follows:

	Percent of Total Capital	Cost	Weighted Cost
Long Term Debt	44.00%	5.48%	2.411%
Common Equity	56.00%	~~10.03%~~	~~5.617%~~
		10.~~61~~84%	~~5.942~~ 6.070%
Total Capital	100.00%		

Weighted Average Cost of Capital ~~8.028%~~8.~~353~~481%

2. Peoples Gas

Based on the evidence in the record and the applicable legal principles, the Commission approves as just and reasonable an overall rate of return (weighted average cost of capital) for Peoples Gas of ~~7.884~~ 8.~~209~~337% calculated as follows:

	Percent of Total Capital	Cost	Weighted Cost
Long Term Debt	44.00%	5.28%	2.~~411~~323%
Common Equity	56.00%	~~9.93%~~ 10.~~51~~74%	~~5.561%~~ ~~5.886~~ 6.014%
Total Capital	100.00%		

Weighted Average Cost of Capital ~~7.884%~~8.~~209~~337%

VIII. Proposed Rider ICR (Peoples Gas) – Part I

A. The Arguments of Staff, the AG, and CUB Fail to Support Any Reversal or Modification of the Proposed Order's Conclusion that Rider ICR Should Be Adopted as Proposed by Peoples Gas With the Accepted Modifications of Staff

Staff, the AG, and CUB each submitted Briefs on Exceptions raising the same arguments against Rider ICR as in their Initial and Reply Briefs. As properly concluded by the Proposed Order, none of these tired arguments supports their knee-jerk opposition to an infrastructure cost recovery rider that will benefit customers, is supported by the City and the Union, will create jobs, and falls squarely within the Commission's authority.

The City of Chicago is a world class cultural and commercial city, but approximately half of its natural gas distribution system is still comprised of cast iron and ductile iron mains providing low-pressure gas service that is a legacy from the time when Peoples Gas created gas from coal to supply fuel for lighting. Marano Dir., PGL Ex. SDM-1.0 Rev. at 14:255 - 16:305, 18:312-326. Some of these pipes are over 100 years old, dating back to the 1860's. *Id*. at

5:109-110. Rider ICR is a proposal that will help enable Peoples Gas to provide a new, modern gas distribution system for the City of Chicago sooner than otherwise possible by use of a rider, a cost-recovery mechanism that clearly is within the Commission's power to adopt. It is well-established that the Commission has the discretion under the Public Utilities Act, 220 ILCS Act 5, to authorize rider recovery, and the Commission has exercised this authority in a variety of situations in recent years.[22] Moreover, as Peoples Gas' expert witness, Salvatore Marano, documented in his testimony, similar cost recovery mechanisms had been approved by state utility commissions for the infrastructure replacement programs of at least twenty natural gas distribution companies as of December 2007. *Id*. at 36:668 – 37:678.

In Peoples Gas' last rate case, the Commission specifically established the standard a utility must meet to obtain a rider for the recovery of main replacement costs, setting forth the following list of information that must be provided:

- a detailed description and cost analysis of the proposed system modernization;
- an identification, evaluation and justification of the technology involved;
- a detailed identification and description of the improved functionalities of the modernized system both for the company and for customers;
- an analysis of the benefits of the system modernization in terms of reduced operating and maintenance costs, enhanced system safety, improved customer safety and reliability, reduced greenhouse gas emissions and increased options for energy efficient appliances, new products and services;

[22] *E.g.*, *Peoples 2007* at 138-153, 183-184 (revenue decoupling pilot in Rider VBA and recovery of energy efficiency program costs in Rider EEP); *In re Northern Illinois Gas Company d/b/a Nicor Gas Company*, ICC Docket No. 08-0363, at 157-58 (Order March 25, 2009) (*Nicor 2008*) (recovery of energy efficiency program costs in Rider EP); *In re Commonwealth Edison Company*, ICC Docket No. 07-0566, at 137-143 (Order Sept. 10, 2008) (recovery of costs for Smart Grid technology and Advanced Metering Infrastructure ("AMI") in Rider SMP).

- 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 and regulatory barriers to the implementation of system modernization.

Peoples 2007 at 162. In *Nicor 2008*, the Commission removed any doubt that these are the elements that apply to determining the approval of Rider ICR, expressly stating that these six requirements are what a utility must meet in order to obtain a rider for the recovery of main replacement costs. *Nicor 2008* at 169-170.

As outlined in its Initial Brief (at 109-129), Peoples Gas has satisfied these six requirements from *Peoples 2007*. Indeed, in its Initial Brief (at 47-48), the AG conceded that Peoples Gas met these requirements. Moreover, that evidence shows only benefits to customers for the accelerated system modernization that Rider ICR will help enable. The following is a partial summary of those benefits:

- Upgrade to state-of-the-art materials for mains and services, using mostly polyethylene pipe which is not subject to corrosion or stress-related cracking (Marano Dir., PGL Ex. SDM-1.0 Rev. at 23:397-401, 34:626-630);
- Upgrade to a medium-pressure distribution system which will eliminate water-infiltration and the service outages such infiltration may cause (*id*. at 7:130-138, 34:636-641) and which may be necessary for the system to be compatible with standard residential appliances in the future (*id*. at 38:703-708);

- Net construction cost savings of \$272.3 million (*id.* at 54:997- 000, 54:1006-1010; PGL Exs. SDM-1.16 Rev., SDM-1.18 Rev., and SDM-1.19; Marano Reb., NS-PGL Ex. SDM-2.0 at 12:254-260);
- Savings of \$244 million in Peoples Gas' ongoing operations and maintenance ("O&M") costs (over what those costs would be over the life of the current main replacement program) by substantially reducing the amount of leak repairs, leak surveys, leak rechecks, emergency responses, regulator station inspection and maintenance, vault survey and maintenance, lost gas and inside safety inspections (Marano Dir., PGL Ex. SDM-1.0 Rev. at 54:1000-1001, 55:1016-1017, 65:1220-1224; PGL Ex. SDM-1.17 Rev.);
- Reduction of the congestion of utilities in the street, future maintenance costs, the potential for excavation damage to gas facilities from third parties, the average length of service lines and long side services, and program installation costs by moving mains to parkways from the middle of the street, where possible (Marano Dir., PGL Ex. SDM-1.0 Rev. at 45:835-841, 67:1252-1263);
- Increased safety for customers, emergency response personnel and gas workers by the removal of the higher-risk cast iron and ductile iron materials, installation of excess flow valves that reduce potential property damage caused by a damage service line, the ability to shut off gas to a building from outside meter sets in cases of fire or other emergency, and the ability of gas crews to isolate gas leaks quickly by closing an existing valve or squeezing off the pipe upstream or downstream from the leak (*id.* at 21:361 - 23:396, 31:565-572, 46:871-873, 46:876-878, 32:589-591);

- Increased availability of cost-saving, energy-efficient appliances (*id*. at 39:711-717, 39:719-724, 43:800-808; PGL Ex. SDM-1.11);
- Reduction in greenhouse gas emissions and elimination of the need to collect, test and dispose of water that enters a low-pressure system (Marano Dir., PGL Ex. SDM-1.0 Rev. at 41:769 - 43:798); and
- The creation of a substantial number of jobs (*id*. at 72:1379 - 74:1413; Marano, Tr. at 887:22 - 888:3).

There has never been any question as to the eventual need for Peoples Gas to replace its aging infrastructure, and, based on the record evidence, there now is no doubt that the costs of accelerating that replacement which Rider ICR will help enable are greatly outweighed by the quantitative and qualitative benefits acceleration would provide. Indeed, these are the very reasons the City and the Union have argued in favor of the Commission adopting Rider ICR. Accordingly, the situation is proper and the circumstances are lawful and reasonable for the Commission to authorize Rider ICR.

While all of the arguments against Rider ICR already have been addressed by the Proposed Order and Peoples Gas' Initial and Reply Briefs and the briefs submitted by the City and the Union, certain reasons the arguments in the Staff, AG, and CUB Briefs on Exceptions should be rejected will be highlighted here without repeating the reasons to approve Rider ICR in their entirety.

B. Rider ICR Will Enable Numerous Benefits, Not Harm, to Ratepayers and Will Be Subject to Adequate Oversight to Ensure That Ratepayers Are Protected

The common, but unsupported, theme running through the positions of these parties is that Rider ICR should be rejected because Peoples Gas cannot be trusted and that the intent of Peoples Gas in obtaining Rider ICR is to gouge ratepayers. Yet, Staff, AG, and CUB offer nothing but hyperbole and conjecture to support this incorrect notion. The actual evidence demonstrates that there is no truth to these tales. Indeed, their positions are belied by the very nature of Peoples Gas' proposal at issue here -- an infrastructure cost recovery rider that, as summarized above, will help enable Peoples Gas to bring numerous cost-saving, safety-enhancing, and environmentally-friendly benefits and functionalities to customers sooner than otherwise possible, as well as create additional job opportunities. This is not a situation where a utility allowed its infrastructure to deteriorate and is now seeking to impose additional costs on its customers to allow it to "catch-up," as suggested in Staff's brief. The uncontroverted evidence -- conceded by Staff's own witness -- is that Peoples Gas' distribution system is safe and operated in a safe manner. Stoller, Tr. at 899:6-13. Rather, this proposal evidences that Peoples Gas is being proactive and acting to keep ahead of the curve of obsolescence in its system's materials so that no costly "catch-up" ever is needed, as well as to create the benefits enumerated in the record and the ALJPO for ratepayers. Marano Dir., PGL Ex. SDM-1.0 Rev. at 29:510 - 31:556.

The only attempt to point to any evidence that Peoples Gas could not be trusted in this endeavor was based on a mistaken interpretation of the history of the company's cast iron / ductile iron ("CI/DI") main replacement program by a Staff witness. While not raised again by Staff in its own Brief on Exceptions, the AG continues to assert that Mr. Stoller's testimony concerning Peoples Gas' performance in replacing CI/DI main in comparison to recommendations contained in the original Zinder study in 1981 shows Peoples Gas has not been diligent in pursuing main replacement on its own. The AG errs. Their inference completely ignores the evidence that the recommendations in this 1981 report applied only to specific CI/DI mains buried in clay soil, not the company's entire system, and that a subsequent study had recommended pushing back the target date for replacing CI/DI mains. Doerk Sur., NS-PGL Ex. ED-3.0 at 4:73-77, 4:80 - 5:90. The AG also ignores the uncontroverted evidence that to date, Peoples Gas has achieved a replacement rate greater than recommended by those consultants. *Id*. at 5:107 - 6:120. Thus, contrary to the AG's arguments, the evidence shows only that Peoples Gas has been diligent in doing the right thing with respect to replacing its CI/DI mains, and that there is no reason to assume Peoples Gas will not do the same when its main replacement program is accelerated.

Furthermore, the AG's apparent fears that Peoples Gas will not accelerate main replacement if Rider ICR is implemented are misplaced. The record is clear -- both in this proceeding and in the previous rate case -- that Peoples Gas fully intends to accelerate its main replacement program if Rider ICR is approved. *See* Schott Dir., PGL Ex. JFS-1.0 Rev. at 14:288-290; Schott, Tr. at 73:1-13, 148:4-10. Peoples Gas retained Jacobs Consultancy to perform its analysis of the accelerated program and prepare the initial implementation plan submitted with Mr. Marano's surrebuttal testimony for purposes of preparing to accelerate its main replacement program. Of course, the acceleration of the main replacement program will also be subject to scrutiny under the various reporting procedures to be put in place by Rider ICR itself.

The AG also attempts to point to the reduction in capital spending in Peoples Gas' 2009 and 2010 budgets as evidence that the company will not really accelerate main replacement if Rider ICR is adopted. However the AG's arguments fail to acknowledge that those reductions were caused by a short-term financial situation brought on by the general economic downturn and that those reductions occurred without Rider ICR. Furthermore, these 2009 and 2010 capital expenditure reductions do not, as the AG continues to assert, undermine the ability of the company to complete an accelerated main replacement program by 2030. As Mr. Marano testified, Peoples Gas retains the workforce and physical resources to achieve an average annual main replacement rate to meet that schedule if Rider ICR is adopted and acceleration begins in 2011 as shown in Mr. Marano's analysis. Marano, Tr. at 884:10 - 887:6.

The AG next offers "chicken little" cries that Rider ICR will destroy a 100 year-old "regulatory bargain" or cause a sea change in the way utility infrastructure is financed. In fact, riders are a part of traditional ratemaking, and Rider ICR will not cause the regulatory sky to fall. Riders have long been part of the way the Commission sets rates, with a history going back over 50 years as outlined in the ALJPO (at 176) to when the Illinois Supreme Court recognized the Commission's authority to approve riders in *City of Chicago v. Illinois Commerce Comm'n*, 13 Ill. 2d 607 (1958) ("*City I*"). Also, as recognized in the Proposed Order (at 176), Rider ICR does nothing more than is already done generally for water utilities. ALJPO at 176; *see* 83 Ill. Admin. Code Part 656.

Also, Staff's and AG's concerns about Rider ICR giving the Company some type of "blank check" to spend ratepayer money without knowing how it will be used or without any scrutiny is false for several reasons. First, Rider ICR allows for recovery only of costs associated with the replacement of existing plant related to the CI/DI main replacement program. PGL Ex. VG-1.1 at p. 88 (Rider ICR, Section D(a)). These are costs for work all interested parties to this proceeding agree must be done. Stoller Dir., Staff Ex. 14.0 at 6:161 (requesting that accelerated main replacement be ordered); AG BoE at 13 (clarifying that the AG does not oppose accelerated main replacement); CUB BoE on Rider ICR at 5 (clarifying that CUB did not take a position in opposition to accelerated main replacement). Indeed, Staff would have the Commission <u>order</u> that this work be done. Stoller Dir., Staff Ex. 14.0 at 6:161; Stoller Reb., Staff Ex. 28.0 at 6:155 - 160. Thus, Staff's and AG's arguments that the costs recovered under Rider ICR would be unbounded or unreasonable are baseless. Second, as recognized by the Proposed Order, Rider ICR requires annual reporting and audits. The costs recovered via the rider are subject to annual reconciliation review and open to prudency challenges, with Peoples Gas willing to provide additional reporting or updating as required for the Commission. Thus, contrary to the Staff and AG claims, the costs recovered under Rider ICR as well as the work and pace of the work will indeed be subject to scrutiny by the Commission.

Furthermore, Staff, AG, and CUB fail to acknowledge that due to the 5% cap included in Rider ICR (as proposed by Staff in the previous rate case), a significant portion of the costs Peoples Gas will incur in accelerating its main replacement program will continue to be recovered in general rate cases. *See* Schott, Tr. at 154:19 - 155:1; PGL Ex. VG-1.1 at §C(a) (limiting recovery under Rider ICR to 5% of base rate revenues). Accordingly, the ongoing scrutiny of the work performed and costs incurred by Peoples Gas in its accelerated main replacement program provided for under Rider ICR will be in addition to, not in lieu of, the scrutiny that the program will receive in general rate cases. Thus, the work Peoples Gas is performing on its main replacement will be subject to more scrutiny <u>with Rider ICR than without</u>.

While the AG is correct that approval of Rider ICR is not approval of the accelerated program itself, the evidence submitted concerning the accelerated program which Rider ICR will help enable and pay for was the evidence requested and required by the Commission for consideration of Rider ICR. *See Peoples 2007* at 162; *Nicor 2008* at 169-170. Nor, as the AG posits, were the ALJs confused by this difference. The ALJs clearly understood the difference and properly concluded that Rider ICR should be approved because the evidence demonstrated that the requirements set forth by the Commission in *Peoples 2007* were met. This understanding is shown in the Proposed Order's conclusion that: "The City of Chicago has it right. The Commission is in the position of removing disincentives to the acceleration of system modernization and it is the record that compels us to this end." ALJPO at 180 (emphasis added).

C. The Proposed Order Applied the Proper Legal Standards to Adopt Rider ICR

Contrary to the arguments of Staff, the AG, and CUB, the ALJPO applied the proper legal standards to weigh the record evidence and conclude that the adoption of Rider ICR is a proper exercise of its authority. Based upon *City of Chicago v. Illinois Commerce Commission*, 13 Ill. 2d 607, 614 (1958), and *City of Chicago v. Illinois Commerce Commission*, 281 Ill. App. 3d 617, 627-629 (1st Dist. 1996) ("*City III*"), the Proposed Order correctly concluded that the Commission has the authority to authorize riders in appropriate circumstance so long as the Commission does not act arbitrarily, capriciously, or irrationally. ALJPO at 176. As explained in the Proposed Order, the Commission established what the appropriate circumstances are for the approval of a Rider ICR in *Peoples 2007* by setting forth the six standards by which the ALJs evaluated the evidence in this proceeding. *Id*. at 166-67. As stated in the Proposed Order, the Commission set forth these six standards in *Peoples 2007* so that Peoples Gas and other utilities could know "what outcomes might reasonably be expected in future cases." *Id*. The Proposed Order thoughtfully details all of the evidence presented by each of the interested parties and weighed that evidence to conclude that each of the six standards was met and that the evidence established that the circumstances are appropriate for the adoption of Rider ICR. It is beyond contention that this analysis was not arbitrary, capricious or irrational. Accordingly, the Proposed Order's conclusion that Rider ICR be adopted must stand.

Staff, the AG, and CUB also contend that Rider ICR should not be adopted because Peoples Gas had not established a "need" for the rider. They rely upon the testimony of Staff witnesses Mr. Lazare and Ms. Kight-Garlisch and AG witness Mr. Rubin for this argument. However, none of these witnesses offer any support other than their own naked opinion for the basis of this purported "needs" standard. *See* Lazare Dir., Staff Ex. 9.0 at 3:56 - 5:104; Kight-Garlisch Dir., Staff Ex. 8.0 at 22:405 - 419; Rubin Dir., AG-CUB Ex. 3.0 at 3:38 - 5:82. The reason for this is that there is no support or basis for a "needs" standard under Illinois law. None of the cases addressing the Commission's authority to adopt riders -- which are cited by each of the interested parties -- mentions, refers to or establishes such a standard. Nor do the decisions of the Commission itself. The Commission is authorized to approve rates that are just and reasonable; a utility need not show that it cannot function without any particular rate to meet that standard. 220 ILCS 5/9-101.

The AG strains to find support for such a standard in the language of the Commission's order in Nicor's last rate case, ICC Docket No. 08-0363, which refers to Nicor failing to provide facts establishing "the need for this Rider." *See* AG BoE at 12 (quoting *Nicor 2008* at 170). This selective quoting of the Nicor order by the AG completely ignores the section preceding it, which quotes the language of *Peoples 2007* setting forth the six standards as "what a utility must present <u>in order to establish a need for a Rider recovering main replacement costs</u>." *Nicor 2008* at 169 (emphasis added). Of particular note, the AG ignores the following conclusion of the Commission in *Nicor 2008*:

> Nicor's evidence does not establish that it meets the requirements set forth above, which were articulated in the Peoples Gas Rate Case Order. In the future, we encourage parties to adhere to the evidentiary requisites set forth in one of our orders, when, as is the case here, that order is directly on point as to what proof is needed to establish a particular argument.

Id. at 170.

Thus, the truth is the <u>exact opposite</u> of what the AG asserts concerning *Nicor 2008*. As the quoted portions of the Nicor order above clearly establish, the Proposed Order's statement of the standards by which Peoples Gas' proposed Rider ICR should be judged is 100% consistent with the Commission's order in *Nicor 2008*, which clarified that what a utility must do to obtain a main replacement cost rider is satisfy the six standards set forth at page 162 of *Peoples 2007*. Here, the ALJs correctly applied those six standards to conclude that the circumstances are appropriate for the adoption of Rider ICR.

The Proposed Order also properly disposed of the single-issue ratemaking, retroactive ratemaking, and test year rules arguments asserted against Rider ICR. The Staff's, AG's, and CUB's briefs on exception raise no new arguments on these points, each of which are addressed by the ALJPO as well as by the Initial and Response Briefs of Peoples Gas. In short, the Proposed Order correctly concludes that Rider ICR does not violate the prohibition against single-issue ratemaking because the savings factor included in Rider ICR accounts for any changes to the components underlying Peoples Gas' rate of return Rider ICR might cause, so the rider will not create any over or understatement of the company's overall revenue requirements. *Bus. and Prof. People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 244-245 (1991) ("*BPI II*"); *City III*, 281 Ill. App. 3d at 627-629.

As the Proposed Order found, the AG's retroactive ratemaking argument is, likewise, baseless. Pass-through cost riders that charge customers based on formulas are allowed by the Act and have been upheld by the Illinois Supreme Court in *Citizens Utility Board v. Illinois Commerce Comm'n*, 166 Ill. 2d 111, 121 (1995) ("*CUB*"), and *City I*. *See also Commonwealth Edison Co.*, ICC Docket No. 05-0159 at 52 (Order, Jan. 24, 2006) (authorizing a pass-through cost recovery rider with annual reconciliation hearings requiring a prudence review). Accordingly, Rider ICR does not violate retroactive ratemaking by passing costs through to ratepayers and then subjecting those costs to a prudence review, which might result in refunds. Moreover, the AG's arguments concerning the Proposed Order's reliance on *CILCO* improperly confuses the *CILCO* decision's holdings regarding single-issue ratemaking and retroactive ratemaking. Here, the Proposed Order properly relied upon *CILCO* to reject the AG's retroactive ratemaking argument.

Finally, the Proposed Order correctly rejected the AG's argument based upon the Commission's test year rules. The AG's attempt to distinguish *CUB* from the present case based upon the fact that the costs in that case were "recoverable through a rider" (AG BoE at 28) fails, for it presupposes that the costs at issues here - main replacement costs -- are not recoverable by a rider. As discussed above, main replacement costs <u>are</u> recoverable by a rider when the standard set forth by the Commission has, as in this case, been established by the evidence.

D. The Proposed Order Correctly Rejected the AG's Revenue <u>Requirement Analysis as a Basis for Rejecting Rider ICR</u>

The AG also continues to rely upon the "revenue requirement" analysis prepared by Mr. Rubin as a basis for rejecting Rider ICR, asserting that it was uncontroverted. This issue has been addressed fully in Peoples Gas' Initial and Reply Briefs. As the Proposed Order properly concluded, Mr. Rubin's conclusions were refuted by the testimony of witnesses Grace, Schott, and Marano, and Mr. Rubin failed to accurately demonstrate how revenue requirements would be created under either Rider ICR or a traditional rate case scenario. Grace Sur., NS-PGL Ex. VG-3.0 at 37:819 - 826, 38:827 - 829; Grace, Tr. at 166:13 - 171:10; Schott Sur., NS-PGL Ex. JFS-3.0 at 11:243 - 12:251; Marano Sur., NS-PGL Ex. SDM-3.0 at 8:168 - 11:246.

The AG attempts to argue around this flaw by claiming that Rubin's analysis was meant to show the implications of a 2030 completion date versus the existing main replacement program. *See* AG BoE at 19. In addition to being a distinction without a difference, this is a *post hoc* attempt by the AG to change the record, as Mr. Rubin's testimony clearly stated it was being offered to show the impact of Rider ICR on customers. *See* Rubin Reb., AG-CUB Ex. 6.0 at 6:104-113. It was purportedly an analysis to show "the costs customers actually would pay" if Rider ICR was authorized. *Id*. Yet, as demonstrated by Peoples Gas in its briefs and concluded by the Proposed Order, Mr. Rubin fails to show how revenue requirements would be generated under either scenario, and his claims are, thus, divorced from reality.

Moreover, the AG conveniently continues to ignore the fact that because of the way revenue requirements work, if the costs of the main replacement program without acceleration are larger than the costs under an accelerated program, then the overall revenue requirements without acceleration will be larger. *See* Rubin, Tr. at 1010:17 - 1011:10. As Mr. Rubin was forced to admit on cross examination, in his hypothetical world, the current main replacement program would generate larger overall revenue requirements than the accelerated man replacement program if Rider ICR is adopted. *Id*. The AG obtains its $3 billion more in revenue requirements for acceleration figure by looking only at a hand-picked time-period tailored to generate the biased and baseless conclusion Mr. Rubin advocates. *Id*. at 1008:20 - 1011:10. Such outcome-determinative analysis provides no basis for overturning the Proposed Order's carefully weighed decision to adopt Rider ICR.

Finally, as recognized by the Proposed Order (at 172), Mr. Rubin admitted that the decision on whether or not to implement an infrastructure investment program such as Rider ICR should not be based solely on cost, but on factors such as safety and reliability, as well. Rubin, Tr. at 984:15-18. These are the factors relied upon by the City and Union for their support of Rider ICR, and the type of evidence completely ignored by the AG's arguments. City Init. Br. on Rider ICR at 3-5; Union Init. Br. at 2-3. As concluded by the Proposed Order, the un-rebutted evidence concerning enhanced safety, energy conservation, increased functionalities and appliance choices and reduced environmental impacts weighs in favor of Rider ICR's adoption.

IX. Staff's Proposals and Rider ICR (Part II)

Staff does not argue for any of its proposals in its Brief on Exceptions except for the ordering of acceleration in a separate Docket. The AG appears to continue to argue for adoption of each of Staff's recommendations. Neither Staff nor the AG, however, addresses the main basis for the Proposed Order's rejection of these proposals: not one shred of evidence was submitted by any party that actually supported these recommendations. As established by Peoples Gas in its Initial and Reply Briefs and the Union in its brief, no party submitted any evidence establishing that the standard established by Section 8-503 of the Act for the ordering of an accelerated program or the standard for imposing outside consultants established by Section 8-102 of the Act. 220 ILCS 5/8-503, 8-102. Based on the absence of any such evidence, the Proposed Order correctly found that Staff's proposals should be rejected. NS-PGL Init. Br. at 129-134; NS-PGL Rep. Br. at 81-84.

Also, neither Staff nor AG has any answer to Proposed Order's conclusion that if, at any time, it is determined that Peoples Gas is not accelerating in a prudent manner or is spending money on the program improperly, a proceeding can be filed at that time. As already discussed, Rider ICR provides for sufficient monitoring and reporting so that if Peoples Gas is not implementing the acceleration of main replacement properly, the Commission or other interested party will have sufficient notice upon which to act. Furthermore, the Proposed Order correctly accepts the Union's and Peoples Gas' argument that there is no basis to micro-manage Peoples Gas by reviewing and approving which particular piece of main will be replaced when, by whom, and how. As admitted by Staff, it is not properly staffed to perform such a function (Stoller Reb., Staff Ex. 28.0 at 2:51 - 3:54), and the reason is that it is not the proper function of a regulatory body such as the Commission to manage and operate a utility at this level. 220 ILCS 5/4-101 (authorizing Commission to have "general supervision" of utilities). The Proposed Order appropriately concluded that the need for such extraordinary, disruptive, and costly regulatory measures had not been established here.

XII. Rate Design

A. General Rate Design

1. Allocation of Rate Increase

The Proposed Order correctly concluded that the Utilities proposed a reliable means of allocating the rate increase that did not suffer from the inconsistencies in Staff's method. ALJPO at 205. The Commission Staff disagrees. Staff BOE at 87-88. Staff contends that its witness Ms. Harden's Schedules 24.1 N and 24.1 P can "automatically and quickly calculate final rates." *Id*. at 88.

First, the Utilities' rate design witness Ms. Grace identified many errors with the Staff witness' schedules. The Staff's post-hearing briefs and its Brief on Exceptions do not address these problems. To list only a few of many examples, Staff's schedules:

- ignore the cost differences and cost allocations between rate classes and assume that all Staff-proposed adjustments could be equally applied to customer, demand, and commodity-related costs, although those adjustments were specific and not derived on an across the board basis;

- improperly adjust: (a) charges that the Utilities did not propose to change; (b) charges based on specific cost-based revenue requirement components; and (c) cost-based charges based on expenses that would be unaffected by Staff's proposed adjustments; and
- have conceptual problems and formulaic errors, and some of the formulas and outcomes are inconsistent with Staff's testimony.

Grace Sur., NS-PGL Ex. VG-3.0 at 9:191 - 19:423. These problems are summarized on pages 143-146 of the Utilities' Initial Brief. The Staff's schedules may "automatically and quickly" calculate rates, but those rates will be inaccurate.

Second, only the Utilities prepared embedded cost of service studies ("ECOSSs"). Thus, the Utilities would have to factor into final costs and rates any Account-specific adjustments required by the Order. Neither Staff nor any party contested the adequacy and sufficiency of the ECOSSs. Staff reviewed the Utilities' ECOSSs and concluded that they were acceptable guidance tools for setting rates. Harden Dir., Staff Ex. 10.0 at 13:246-247; 36:742-743.

For reasons of accuracy and efficiency, the Utilities' ECOSSs and rate design methodologies should be used to determine final rates based on the Order. Staff's exceptions should not be adopted.

2. Account 904 Uncollectible Expense

The Proposed Order correctly concluded both that it is proper to continue to reflect in rates differentiation for gas cost-related Account 904 costs between sales and transportation customers and that the customer charge is the proper charge to differentiate. ALJPO at 211-212. The Staff and the AG dispute the Proposed Order's inclusion of differentiation in the customer charge.[23] Staff and the AG each cite Staff witness Ms. Harden's testimony that the uncollectible expense is comprised of fixed and variable charges, which they describe as customer, distribution and demand charges. Staff BOE at 88; AG BOE at 53. Staff also stated that, contrary to the Proposed Order's conclusions (ALJPO at 211-212), its method can be adapted to address the uncollectible expense rider permitted under Senate Bill 1918. Staff BOE at 88-89. The AG argues that simplifying the Rider VBA calculations is not a reason to have cost differentiated customer charges. AG BOE at 53.

The Proposed Order's resolution of these issues is correct. The starting point for this rate design issue is the Utilities' ECOSSs. In their ECOSSs, the Utilities each functionalized Account 904 costs[24] to the customer function, Customer Accounts category; classified these costs to the Customer category; and allocated these costs based on the "Bad Debt allocation methodology." Hoffman Malueg Reb., NS-PGL Ex. JCHM-2.0 at 8:158 - 9:171. For cost classification purposes, Account 904 costs are a function of customers' unpaid bills. The bills' components (fixed or variable; customer or distribution charges) are irrelevant. If a customer does not pay his bill, the unpaid amount becomes an uncollectible account expense, irrespective of the underlying components of the unpaid bill. Hoffman Malueg Reb., NS-PGL Ex. JCHM-2.0 at 9:173-176.

The Staff and the AG are confusing cost of service issues with rate design. The components of the bill are the "rate design," as Staff agreed. Harden, Tr. at 952:20 - 953:1. The ECOSS issue is how to functionalize, classify and allocate Account 904 costs. The rate design

[23] The AG further excepts to any differentiation, but the AG addresses this issue, and the Utilities respond, in Section XII(B)(2)(a), *infra*.

[24] Note that the rate design issue is limited to gas cost-related Account 904 costs.

witness uses the ECOSSs to develop the rate design. Hoffman Malueg Dir., NS Ex. JCHM-1.0 at 2:33-36; Hoffman Malueg Dir., PGL Ex. 1.0 Rev. at 2:33-36; Harden, Tr. at 951:10-17. Hence, the rate design differentiation of gas cost-related Account No. 904 costs in the customer charge follows logically from the classification of Account No. 904 costs as "customer costs" in the ECOSSs. Grace Reb., NS-PGL Ex. VG-2.0 Rev. at 5:99-102.

The record does not support Staff's assertion (Staff BOE at 89) that it can accommodate the Account 904 issues raised by Senate Bill 1918. For Account 904 costs, the problems with Staff's schedules are particularly acute as they do not agree with other Staff testimony. Specifically, Ms. Grace explained:

> Her [Ms. Harden's] formulaic methodology, which treats all expenses equally, is akin to a black box that would not allow the Utilities to accurately quantify nor identify the amount of total Account 904 Costs which are included in their base rates. Using Ms. Harden's gas cost related Account 904 Costs alone would cause the Utilities to incorrectly refund amounts below the artificially derived and much too high, Account 904 Costs arising from her rate design proposals. This is evidenced in Ms. Harden's Account 904 Costs shown in NS-PGL Exs. VG-3.1N and VG-3.1P, which show that Account 904 Costs from her rate proposals exceed that in Staff's proposed revenue requirements, which underlie her rates.

NS-PGL Ex. VG-3.0 at 20:438-446. In other words, one Staff proposal (revenue requirement) disagrees with another Staff proposal (rates). For Peoples Gas, the gas cost-related Account 904 costs that could be derived from Staff witness Ms. Harden's proposed rates are $2.2 million over the amount of such costs in Staff's underlying revenue requirement, and for North Shore the amount is $628,000. NS-PGL Exs. VG-3.1N and 3.1P.

The AG's dismissal of the benefit of simplification of Rider VBA calculations is tangential to the differentiation question. As the Utilities made clear, the simplification is an ancillary benefit of the rate design decision and not the driving force. NS-PGL Init. Br. at 148.

Finally, the Utilities note that Staff and the AG each cite testimony that inaccurately describes the Utilities' rate designs. While it is true that some rate designs include customer, distribution and demand charges, that is not the case for all the Utilities' service classifications. For example, Staff witness Ms. Harden's own rate exhibits show that Service Classification ("S.C.") Nos. 1 and 2 for each company include a customer charge and a distribution charge but no demand charge. Harden Reb., Staff Ex. 24.0, Scheds. Staff Ex. 24.1 N (Corr.) and 24.1 P (Corr.).

For these reasons, the Staff's and the AG's Exceptions should not be adopted, and the Utilities' clarifications (NS-PGL Exception No. 19) should be adopted.

B. Service Classification Rate Design Issues

2. Contested Issues

a. North Shore and Peoples Gas Service Classification Nos. 1 and 2 Customer Charge

The Proposed Order correctly concluded that it is proper to differentiate the customer charges for S.C. Nos. 1 and 2 sales and transportation customers and to slightly increase the amount of fixed cost recovery in the customer charges. ALJPO at 220. Staff and the AG except to the increase in fixed cost recovery, and the AG excepts to differentiation. Staff BOE at 90-91; AG BOE at 54-58.

The slight increase in the amount of cost recovery through the S.C. Nos. 1 and 2 customer charges is sound ratemaking, consistent with Commission policy and does not disrupt the Utilities' decoupling pilot (Rider VBA).

For Nicor, the Commission approved recovery of 80% of fixed costs through the customer charge. The Commission stated that "[m]oving a greater percentage of fixed cost recovery to fixed charges rather than volumetric charges provides a more stable revenue stream and sends a better price signal to the consumer." *Nicor 2008* at 91. In Peoples Gas' 1995 rate case, the Commission, in approving the proposed customer charge, stated that it "in fact, should be increased in future rate proceedings to move it closer to cost." *In re The Peoples Gas Light and Coke Company*, ICC Docket No. 95-0032 (Order, Nov. 8, 1995). In the Utilities' last rate cases, the Commission approved an increase in fixed cost recovery through the customer charge to 50% of the S. C. No. 1 revenue requirement. *Peoples 2007* at 250. The Proposed Order in the instant cases provides for S.C. No. 1 increases to only 55% (North Shore) and 54% (Peoples Gas). ALJPO at 217, 218. This modest increase is consistent with Commission policy and the principle of recovering fixed costs through fixed charges.

Concerning Rider VBA, the proposed customer charges for the service classifications to which it applies (S.C. Nos. 1 and 2) remain far below embedded fixed costs. For Peoples Gas, only about 48% of fixed costs would be recovered through fixed charges, which leaves nearly $300 million subject to Rider VBA. For North Shore, the figures are 56% and nearly $40 million. The Utilities would continue to recover these large amounts through variable charges. Thus, significant activity will remain under Rider VBA for purposes of reviewing its effect. Grace Reb., NS-PGL Ex. VG-2.0 Rev at 9:183-190. If Rider VBA is not extended after the pilot ends, the Utilities would continue to have a very large amount of fixed costs to be recovered through variable charges. The Proposed Order only slightly reduces the amount. Under Staff's and the AG's positions, the Utilities could take no steps to mitigate this circumstance during the four years that Rider VBA is in effect, despite the Commission's policy encouraging fixed cost recovery through fixed charges. Grace Reb., NS-PGL Ex. VG-2.0 Rev at 9:190-198. Nothing in the Commission's approval of the Rider VBA pilot requires this result.

For these reasons, Staff's and the AG's Exceptions should not be adopted.

C. Tariffs - Other Tariff Issues

2. Volume Balancing Adjustment (Rider VBA)

a. Establishment of New Margins

The Utilities do not oppose Staff's proposed additional language ("The new RCM compliance filings shall be publicly filed on the Commission's e-Docket system."). Staff BOE at 92.

XIII. Transportation Issues

B. Uncontested Issues

8. Rider SST Unbundled Allowable Bank

The Utilities do not oppose Constellation NewEnergy - Gas Division, LLC's (CNE-Gas) proposed additional language to encourage the Utilities and Staff to solicit input from interested stakeholders concerning the unbundling of certain large volume transportation services. CNE-Gas Exception No. 1. The Utilities note that the fundamental reason this issue is uncontested is that the Utilities committed to work collaboratively with the Staff to develop unbundling proposals. The Utilities expect that collaboration with the Staff will be an efficient way to formalize proposals. However, the Utilities do not oppose seeking input from stakeholders during the process, as successfully occurred with the super pooling issue.

D. Small Volume Transportation Program

The Proposed Order deferred all of the Retail Gas Suppliers' ("RGS") issues to workshops. ALJPO at 256, 258, 263, 269, 272, 274, 275. The Utilities disagree that RGS made a sufficient case for change to the Utilities' small volume transportation program (Choices For You^{sm} or "CFY"). To narrow the contested issues in this proceeding, the Utilities did not except to this outcome. However, they emphasized that, if there are workshops, then the workshops should proceed without presumptions as to the outcome, particularly as to the applicability, if any, of Nicor's programs. RGS continues to argue that the Commission decide most of these issues on the merits in this proceeding. If the Commission does so, it should reject RGS' proposals for the reasons detailed in the Utilities' post-hearing briefs. NS-PGL Init. Br. at 176-184; NS-PGL Rep. Br. at 107-117. RGS alternatively argues that the Proposed Order should presume that certain elements of Nicor's program should be imposed through the workshop process. RGS BOE at 6. The Utilities strongly oppose that proposal.

As stated in the Utilities' Brief on Exceptions, the purpose of the workshops should be to determine what, if any, changes to CFY are appropriate and justified. NS-PGL BOE at 53-54. RGS would apparently have the workshops be an exercise in re-writing Riders CFY and AGG so that these riders match Nicor's program. As shown in the Utilities' post-hearing briefs, RGS' proposals are undeveloped and flawed. NS-PGL Init. Br. at 176-184; NS-PGL Rep. Br. at 107-117. The Utilities proposed no changes to the CFY program, and the proponents of the program changes bear the burden of proof on these issues. *Central Illinois Public Service Company v. Illinois Commerce Comm'n,* 5 Ill. 2d. 195, 211 (1955). Arguing that the Utilities should adopt pieces of Nicor's tariffs, which were appended to the RGS witness' testimony (RGS BOE at 10), without trying to show that these tariffs are reasonable for the Utilities or how to incorporate them into the Utilities' existing tariffs, does not meet RGS' burden of proof. Relying on a Memorandum of Understanding ("MOU") from Nicor's last rate case (RGS BOE at 1-2 (citing proposals "negotiated with Nicor")) does not meet the burden of proof.[25] This is particularly true given that Section 11(B) of that MOU states that it "shall not have any precedential value in proceedings that address the rates or tariffs of Nicor Gas or any other

[25] The Utilities were not a party to the MOU. Nicor is not a party to the Utilities' rate cases.

utility," and Section 11(A) states that no party shall offer it into evidence except in connection with a proceeding related to the performance, implementation or enforcement of the MOU. RGS Cross Ex. Sackett 32 at 5.

In sum, for Section XIII(D) of the Proposed Order, RGS' exceptions should not be adopted, and the Utilities' exceptions (NS-PGL Exception Nos. 22 and 23) should be adopted.

1. <u>Allocation of and Access to Company-Owned Assets</u>

For the reasons stated in the preceding section, RGS' proposals that the Commission either order the Utilities to adopt specific elements of Nicor's tariff or make this a condition of the workshop discussions (RGS BOE at 10-11) should be rejected. CFY suppliers receive substantial rights under the existing CFY program, and the evidence shows that, relative to sales customers, CFY suppliers are receiving equal or better rights. For example, the Utilities' decisions for their sales customers must work around the constraints caused by the CFY suppliers. Those suppliers know by 8:45 a.m. every business day, prior to making purchase decisions, the quantity of gas they will need to deliver to the Utilities. In contrast, the Utilities make daily purchase decisions for sales customers without knowing how CFY deliveries will vary from the projected quantity and must remain prepared to meet CFY variations that are not known until after the fact. Dobson Reb., NS-PGL Ex. RD-1.0 Rev. at 27:591 - 28:603. As another example, the Utilities' storage injection and withdrawal rights are constrained by limitations in the pipeline providers' tariffs or other restrictions that the pipeline imposes (such as in response to *force majeure*). These limitations include injection and withdrawal ratchets and upstream source and transportation requirements. The tariffs limit where the Utilities can buy gas and how the Utilities can transport gas. Peoples Gas' storage field (Manlove Field) also has operating limitations. Conversely, the CFY suppliers deliver gas, within a 10% tolerance band, based on projected customer requirements, without regard to storage and pipeline issues. *Id*. at 28:604-614. CFY suppliers may transport gas to the citygate using any pipeline that interconnects with the Utilities; CFY suppliers have access to storage without having to specifically nominate injections or withdrawals; and CFY suppliers receive a daily balancing service. NS-PGL Ex. RD-2.0 at 13:281 - 14:296.

The record does not support changing the CFY program as it pertains to storage rights. In fact, the record shows that CFY suppliers are at least as well positioned as sales customers in their use of assets, yet they pay less for that use.[26] NS-PGL Init. Br. at 176-178; NS-PGL Rep. Br. at 107-109. If there are to be changes to the CFY storage terms and conditions, those changes should be the product of the workshops.

3. Allocation of Administrative Costs and Related Charges

RGS argues that administrative costs should be spread among all customers eligible for the CFY program. RGS BOE at 11-12. This is a simple question of cost causation. RGS wants all customers to bear the costs caused by serving CFY suppliers. RGS' proposal would have sales customers subsidizing CFY suppliers. Grace Reb., NS-PGL Ex. VG-2.0 Rev. at 64:1407-1417. The CFY Administrative Charge recovers the Utilities' cost of administering their CFY transportation programs. The Utilities presented a specific cost study, identifying the activities and functions and the related costs, to support the proposed CFY Administrative Charges. Grace Reb., NS-PGL Ex. VG-2.0 Rev. at 63:1391-1394; Grace Dir., NS Ex. VG-1.0 Rev. at 26:560-562; VG-1.10; Grace Dir., PGL Ex. VG-1.0 Rev. at 28:613-615; PGL Ex. VG-1.10. The LDC

[26] Sales customers pay a Gas Charge that includes the Non-Commodity Gas Charge ("NCGC"). NS Ex. VG-1.1 at 17; PGL Ex. VG-1.1 at 20. CFY customers do not pay a Gas Charge but do pay an Aggregation Balancing Gas Charge ("ABGC"). The NCGC and the ABGC each recovers non-commodity gas costs, which includes assets like purchased storage. The ABGC, paid by the CFY customers, is less than the NCGC, paid by the sales customers. NS Ex. VG-1.1 at 17; PGL Ex. VG-1.1 at 20.

Billing Option charges recover the Utilities' cost of rendering a bill with supplier-specified charges, on behalf of the supplier, and remitting customer payments to the supplier. Grace Reb., NS-PGL Ex. VG-2.0 Rev. at 63:1400 - 64:1403. The costs in question are properly assessed to CFY suppliers for services those suppliers receive. Assessing these costs to all S.C. Nos. 1 and 2 customers (sales and transportation (CFY and large volume)) would be improper and should be rejected. Moreover, as explained in the Utilities' post-hearing briefs, analogies to the Utilities' Rider EEP and to their customer call center costs are flawed. NS-PGL Init. Br. at 179-180; NS-PGL Rep. Br. at 110-112.

4. <u>Rider SBO Issues</u>

RGS argues that the Commission should require the Utilities to modify Rider SBO to: (1) allow customers with arrearages to remain on Rider SBO; and (2) require the Utilities, at the supplier's direction, to transfer customer credit balances to the supplier. RGS BOE at 13-14. For both issues, the supplier is able to address the situation directly with the customer with whom it has a contractual relationship, whether by ensuring that arrearages are paid before taking actions that could jeopardize the customer's receipt of Rider SBO bills or by arranging for the customer to transfer a credit to it. A change to Rider SBO is unnecessary. NS-PGL Init. Br. at 180-182; NS-PGL Rep. Br. at 113-114.

5. <u>New Customer Issues</u>

RGS argues that the Commission should order the Utilities to alter their current practice under which a customer must be active on the system before he may commence taking transportation service. The Utilities' process, applicable to all service applicants, is that an applicant starts receiving service (becomes active) when the gas is turned on or the Utilities obtain a meter reading. The account is "pending" until such time. McKendry Reb., NS-PGL

Ex. JM-1.0 at 20:436-443. The Utilities do not accept CFY enrollment requests that suppliers submit when customers' accounts are "pending" for practical reasons. Many things can change between the service request and when service orders are scheduled. For example, customers may cancel the service request before the scheduled turn-on date or re-schedule the turn-on date. Also, the Utilities are concerned that activating customers' accounts immediately in supplier's pools is inconsistent with Senate Bill 171's requirement that allows customers a minimum of 10 business days from the Utilities' notice to rescind contracts with their suppliers. *Id*. at 21:445-460. The Utilities' practice concerning new customers is reasonable, and the Commission should not order a change. NS-PGL Init. Br. at 182-183; NS-PGL Rep. Br. at 114-115.

6. <u>Customer Switching Issues</u>

RGS argues that the Commission should order the Utilities to change their customer switching practice. The Utilities' use of a standard 19 calendar days, rather than a ten business day period that would be unique for each request, is reasonable and efficient. Moreover, the ten business day period commences only after the Utilities give notice, and the statute provides up to two business days for that notice. Under favorable circumstances, the statutory process will take 16 days -- two business days for notice plus ten business days for the rescission period. Any twelve business day period necessarily includes two weekends. McKendry Reb., NS-PGL Ex. JM-1.0 at 19:418-422; McKendry Sur., NS-PGL Ex. JM-2.0 at 7:146-149. Any switch request received on a Thursday or Friday will encompass three weekends (six additional calendar days), even with no State holidays. A 19-day presumption is reasonable. It is likewise reasonable for Utilities that serve over 900,000 customers (NS-PGL Init. Br. at 21, 22) who are eligible for the CFY program have an automated process with a generally applicable period to ensure that all customers receive the full rescission period before the Utilities place the customer on transportation service. NS-PGL Init. Br. at 183-184; NS-PGL Rep. Br. at 116.

XIV. Findings and Ordering Paragraphs

Finding Paragraph (26)

The Utilities concur with Staff's proposal to add "pipeline cuts" at the end of this finding. Staff BOE at 92.

CONCLUSION

For the foregoing reasons and the reasons stated in their prior briefs and appearing of record, the Utilities respectfully request that the Commission adopt the Utilities' Exceptions and not adopt the substantive Exceptions proposed by intervenors and Staff, except for the Exception of CNE-Gas relating to the revised super-pooling proposal.

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