STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	)	
	)	**Docket No. 09-0166**
Proposed general Increase in rates for gas service.	)	
	)	**(cons.)**
	)	
The Peoples Gas Light and Coke Company	)	
	)	**Docket No. 09-0167**
	)	
Proposed general increase in rates for gas service.	)	
	)	

STAFF RESPONSE TO NOTICE OF ADMINISTRATIVE LAW JUDGES' RULING TO REOPEN RECORD AND ADMIT DOCUMENTS

The Staff witnesses of the Illinois Commerce Commission ("Staff"), by their attorneys, and pursuant to the December 7, 2009 ruling of the Administrative Law Judges ("ALJs"), respectfully submits this response to the ALJs' ruling to reopen the record and admit documents.

INTRODUCTION

On December 7, 2009, the ALJs issued a Notice of Administrative Law Judges' Ruling ("ALJs' December 7 Ruling") that reopened the record for the sole purpose of admitting the response of North Shore Gas Company ("North Shore" or the "Company") and the Peoples Gas Light and Coke Company ("Peoples Gas" or the "Company") (collectively, the "Companies" or "NS-PGL") for the production of "workpapers WP-PRM-1 and WP-PRM-7 "(as mentioned in the Utilities' Reply Brief on Exceptions at pages 48-49)". ALJs' December 7 Ruling. The ruling allowed the Companies to respond to the ALJs' request by 12 p.m. on December 8, 2009, and further allowed any objection to admission

of the requested documents to be filed by 4:30 P.M. the same day. *Id*. The Companies served their response at approximately 12:46 p.m. on December 8, 2009. Through an email message on December 8, 2009, the ALJs subsequently permitted parties until 10 a.m. on December 9, 2009 to file any objection to admission of the requested documents. Given that the ALJs' reference to the Companies' Reply Brief On Exceptions ("RBOE") as the reason for reopening the record and admitting documents, and that that portion of the Companies' RBOE is so full of misrepresentations of fact and unwarranted attacks on Staff's character, Staff also addresses the most egregious statements in the Companies' RBOE related to this issue.

ARGUMENT

Staff objects to the reopening of the record for admission of the Companies' "workpapers WP-PRM-1 and WP-PRM-7 (as mentioned in the Utilities' Reply Brief on Exceptions at pages 48-49)."[1] As explained below, the lack of detailed information regarding the Companies' updated beta estimate is a deficiency in the Companies' case, and no grounds for granting the extraordinary relief of reopening the record to remedy the Companies' deficiency exist. The fact that the Companies inappropriately characterize their deficiency as a Staff-created problem further undermines the legitimacy of this "request," particularly when combined with the other mischaracterizations and misrepresentations in the Companies' RBOE. Even if these shortcomings were overlooked, and they should not be, the de minimis effect of this new information on the cost of capital estimate further dictates rejection of this request.

[1] In the pdf version of the Companies' RBOE filed on e-Docket and served on Staff, the reference to "workpapers WP-PRM-1 and WP-PRM-7" is in footnote 21, which is contained in the paragraph on pages 47-48 of the Companies' RBOE.

The Proposed Order ("PO") decided to incorporate into the cost of common equity calculation both Staff's and the Companies' CAPM estimates of the cost of common equity.[2] See PO, p. 128. In its Brief on Exceptions ("BOE"), Staff accurately observed that the 0.78 beta parameter included in the Companies' CAPM result reflects a leverage adjustment, although the PO explicitly rejected the Companies' leverage adjustment.[3] Staff BOE, pp. 40-41; PO, pp. 128-129. Staff also accurately noted that, to be consistent with the PO's rejection of the leverage adjustment, the Commission would have to remove the leverage adjustment from the Companies' beta estimate, but the record does not present the data needed to do so. Staff BOE, p. 41. Thus, Staff correctly concluded that Mr. Moul's CAPM estimate of 10.86%, based on a leverage-adjusted beta of 0.78, should not be included in the calculation of the cost of common equity adopted by the Commission. *Id*.

In their RBOE, the Companies acknowledge that the information necessary to properly amend their beta estimate to remove the PO-rejected leverage adjustment is not included in the record. NS-PGL RBOE, p. 47. Incredibly, however, the Companies' RBOE conveniently converts the failure of their case to provide sufficient detail to accommodate the decisions reached in the PO into an alleged Staff deficiency. NS-PGL RBOE, pp. 47-48. Contrary to the Companies' unsupported allegations, it is the Companies' attempt to ignore the failings of their case and mischaracterize the issue as a Staff problem that is the quintessential "red herring." The Companies essentially

[2] Although the PO does not explicitly address size adjustment included in the Companies' CAPM analysis, it was implicitly rejected, as the PO excluded the size adjustment from the CAPM result it adopted.

[3] That oversight is understandable, since Mr. Moul's discussion of his updated beta estimate makes no mention of the leverage adjustment included therein. NS-PGL Ex. PRM-2.0 Rev., p. 8. In fact, the Companies apparently missed it themselves, since Alternative 2 to their 16th Exception proposes to reject their leverage adjustment, yet includes the leverage-adjusted 10.86% CAPM result in the costs of common equity proposed under their Alternative 2 scenarios. NS-PGL Exceptions, p. 129.

argue that Staff should have foreseen and addressed what the Companies failed to – not only anticipate the PO's inadvertent use of the Companies' leverage-adjusted beta notwithstanding the PO's rejection of the leverage adjustment (PO, pp. 128-129), but take extraordinary action on the Companies' behalf by filing a motion to reopen a closed record in order to introduce the Companies' own data, at an exceptionally late point in the proceeding, to salvage the Companies' analysis. Revealingly, the Companies further suggest that Staff's adherence to the legal restriction regarding the use of extra-record evidence is somehow "inappropriate." NS-PGL RBOE, p. 47-48.

In their RBOE, the Companies continued and amplified their strategy of questioning Staff's integrity with unsupported insinuations and allegations of ethical breaches. So numerous are such comments, that Staff could not possibly address them all in this response. However, with regard to this issue, and as a representative example, Staff will address the Companies' desperate attempt to deflect attention from their own failure to provide sufficient details regarding their updated beta by ignoring this fact and instead claiming that Staff knew these details and therefore should be blamed for the Companies' omissions regarding their numbers. NS-PGL RBOE, p. 47.

The Companies argue that "Staff's challenge to Mr. Moul's updated beta is the quintessential 'red herring,'" since Staff knew of this extra-record data the Companies had supplied, among their hundreds of work papers, but refused to cross legal boundaries to introduce it. NS-PGL RBOE, pp. 47-48. This statement is not only dismissive of a perfectly appropriate and necessary exception, but demonstrates a disturbing attitude toward the rules of evidence. Moreover, the Companies claim that Staff "knows that if [the non-record unadjusted] beta [of 0.66 (i.e., without a leverage

adjustment)] 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." *Id*. at p. 47, fn. 20. Rules of evidence notwithstanding, Staff knows nothing of the sort, as the Company presents incorrect calculations and an apples to oranges comparison. The 10.86% result accepted in the PO is Mr. Moul's calculation **excluding** the 0.94% updated size adjustment (4.25% + (0.78 x 8.48%) = 10.86%). However, the Companies' claim that the result of using an unadjusted beta of 0.66 would be 10.79%, which appears to misleadingly **include** Mr. Moul's proposed 0.94% size adjustment (4.25% + (0.66 x 8.48%) + 0.94% = 10.79%), despite the PO's implicit rejection of such an adjustment. Peoples Gas Ex. PRM-1.0 Rev., p. 41; NS-PGL Ex. PRM-2.0 Rev., p. 8; PO, p. 128. The correct result of using a 0.66 beta with Mr. Moul's risk-free rate and market risk premium estimates would be 9.85% (4.25% + (0.66 x 8.48%) = 9.85%), which is 101 basis points lower than the 10.86% result included in the PO. Furthermore, the Companies have the audacity to charge Staff of "inappropriate" behavior for "bas[ing] exceptions to the Proposed Order on matters not of record." NS-PGL RBOE, p. 48. This is not only a blatant and false character assassination, but is a misrepresentation of the facts. Staff's exception is most assuredly not based on "matters not of record." To the contrary, Staff's exception notes a problem with the Companies' CAPM that is clearly demonstrated by the record; namely, the inclusion of a leverage adjustment that was found to be unwarranted and rejected in the PO. What is not in the record, because the Companies failed to include it with their testimony, is the information necessary to correct this flaw in their calculation (i.e., the details of the leverage adjustment inappropriately included in their updated CAPM analysis). Thus, it

is the Companies' failing that precipitated this entire problem, as they failed to fully explain Mr. Moul's update in sufficient detail.[4] Indeed, the description of all the changes in Mr. Moul's entire updated analysis, including all the inputs for three separate models, is limited to a single paragraph in his rebuttal testimony. NS-PGL Ex. PRM-2.0 Rev., pp. 7-8. In contrast, the description in his direct testimony for his CAPM analysis alone was approximately 6 pages long. Peoples Gas Ex. PRM-1.0 Rev., pp. 35-41. Now, the Companies suggest that it is Staff's responsibility to take extraordinary action to do for the Companies what they failed to do for themselves.

It would be inappropriate for the ALJs to reward the Companies' deplorable behavior, and their failure to make their case, through the highly irregular action of opening the record well after it was marked heard and taken in order to allow the use of data that the Companies failed to introduce into the record at a more appropriate time. Moreover, such extraordinary measures would yield a very small change in the overall cost of capital. In fact, the Companies note that the updated, unadjusted Value Line beta, which is not revealed in the record, "is just three basis points [sic] lower than his original unadjusted beta of 0.69."[5] NS-PGL RBOE, p. 47. Staff notes that that updated, unadjusted Value Line beta of 0.66 (0.69 – .03 = 0.66) is equal to the Value Line beta estimate already incorporated into Staff's beta estimate. ICC Staff Exhibit 7.0R, p. 19. Thus, as Staff explained, there is no need to include Mr. Moul's Value Line beta estimate in the CAPM estimate adopted by the Commission. Staff BOE, p. 40.

[4] Ironically, it is the Companies' RBOE assertions regarding the unadjusted beta that were based on non-record information.

[5] The Companies' description of a 0.03 change in beta as "three basis points" is incorrect. A basis point is one hundredth of a percent (i.e., 0.01% or 0.0001). In contrast, beta is a fraction and is not described as a percent. Thus, a difference in beta of 0.03 is the fractional equivalent of 3% or 300 basis points. Indeed, the PO recognizes this distinction, referring to the difference between beta estimates in "points" rather than "basis points." PO, p. 127.

Nevertheless, if the proposed information is allowed into the record to permit the Companies' CAPM analysis to be utilized, it would produce a CAPM estimate of 9.85% (excluding a leverage adjustment), rather than the 10.79% rate the Companies claim, as shown in the table below.[6]

	R_f		β		R_m - R_f		COE
Post-RBOE CAPM:	4.25%	+	0.66	X	8.48%	=	9.85%

If the revised Company CAPM estimate of 9.85% is averaged with Staff's 9.95% CAPM estimate (per the decision reached in the PO), this would produce a final average CAPM estimate for the Gas Group of 9.90%. Assuming the PO's same 50% weighting applied to the CAPM (i.e., averaging the DCF and CAPM results as determined in the PO) and a 56% common equity ratio, the use of a 9.90% CAPM estimate would result in a mere 8.4 basis point upward adjustment to the overall cost of capital relative to adopting Staff's 9.60% CAPM proposal in its BOE that includes the Companies' market risk premium and risk-free rate estimates, or a minuscule 1.4 basis point downward adjustment relative to relying solely on Staff's 9.95% CAPM estimate.[7] Thus, the minor change in the cost of capital that would result does not warrant the taking of the extraordinary measures necessary to rehabilitate the Companies' flawed CAPM.

[6] As noted above, the Companies' 10.79% estimate appears to incorrectly include Mr. Moul's proposed 0.94% size adjustment.

[7] Staff notes that the Companies misrepresent Staff's position as having "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." NS-PGL RBOE, p. 49. Staff did not abandon Mr. McNally's analysis. In fact, Staff presented, as one alternative proposal, the sole use of Mr. McNally's CAPM result of 9.95%. Staff BOE, p. 42. Staff's other proposal merely provided an alternative reflecting the PO's acceptance of Mr. Moul's other CAPM inputs, while addressing the fact that his adjusted beta estimate could not be properly included. The acceptance of portions of the various parties' analyses as a compromise position is nothing new to the Commission. Indeed, that is precisely what the Commission did in the Companies' last rate case. Order, Docket Nos. 07-0241/07-0242 (Cons.), February 5, 2008, p. 99.

WHEREFORE, for the aforementioned reasons, Staff respectfully requests that the ALJs reconsider their ruling and not reopen the record to admit the Companies workpapers.

Respectfully submitted,

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JOHN C. FEELEY
CARMEN L. FOSCO
MEGAN MCNEILL
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556

jfeeley@icc.illinois.gov
cfosco@icc.illinois.gov
mmcneill@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

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