STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	)	
	)	
Proposed General Increase	)	No. 09-0166
In Rates for Natural Gas Service	)	
	)	
	)	
THE PEOPLES GAS LIGHT AND	)	
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APPLICATION FOR REHEARING OF THE CITIZENS UTILITY BOARD

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APPLICATION FOR REHEARING OF
<u>THE CITIZENS UTILITY BOARD</u>

Pursuant to Section 10-113 of the Public Utilities Act ("PUA" or the "Act"), 220 ILCS 5/10-113, and Section 200.880 of the Rules of Practice of the Illinois Commerce Commission ("Commission" or "ICC"), 83 Ill. Admin. Code 200.880, the CITIZENS UTILITY BOARD ("CUB"), by its attorneys, submits this Application for Rehearing of the Commission's final order in the above-captioned proceeding regarding the increase in rates for Peoples Gas Light & Coke Company ("Peoples Gas" or "PGL") and North Shore Gas Company ("North Shore" or "NS"), collectively the "Companies." For the reasons described in detail below, CUB requests the Commission either reverse itself or conduct rehearing on the issues of Peoples's Rider ICR, the Companies' capital structure and the Companies' cost of common equity. CUB incorporates its past briefings of these subjects, and the underlying evidentiary record referenced in those briefings. CUB-City Initial Brief at pages 11-43; CUB Initial Brief on Proposed Rider ICR;

CUB-City Reply Brief at pages 2 -22; CUB Brief on Exceptions on Proposed Rider ICR; CUB-City Brief on Exceptions at pages 11-51; CUB-City Reply Brief on Exceptions.[1]

I. INTRODUCTION/SUMMARY OF THE ARGUMENTS

1. Proposed Rider ICR

Peoples Gas's proposed rate-tracking mechanism entitled "Infrastructure Cost Recovery" rider, or "Rider ICR," is intended to recover the costs of replacing its aging case iron ("CI") and ductile iron ("DI") (together, "CI/DI") mains and its antiquated low-pressure system. In its January 21, 2010 Order[2], the Commission approved Rider ICR, subject to certain conditions. In particular, the Commission ordered Peoples Gas and Commission Staff ("Staff") "to meet within 60 days of the approval of this Order, outlining how [Peoples Gas] will calculate the portion of the accelerated program that is limited to those determined to be beyond the agreed upon baseline." Order at 180.

Peoples currently has a CI/DI main replacement program in place, a program that has successfully replaced more than 45% of Peoples' CI/DI mains since 1981 without a rider. NS-PGL Ex. ED-2.0 at 5-6, LL. 110-112. In fact, the Company was able to perform these large infrastructure projects over a period of 12 years without even seeking rate relief[3]. Yet it now seeks to accelerate this replacement from the 50 year plan currently operating to a pace resulting in about half that time by requiring the replacement rate of 45 miles-per-year to more than double. Peoples Gas Ex. SDM-1.0 at 42. This is true despite the fact that, in the next year, the Peoples has committed to replace only 10 miles and the next several years the pace will be dramatically slower than its historic average without a rider.

[1] "City" is the City of Chicago, by its attorney Mara S. Georges, Corporation Counsel.
[2] The Commission's Order was served on the parties on January 22, 2010.
[3] The Company went from 1995 to 2007 without seeking rate relief.

In its Order, the Commission first reviewed whether Peoples Gas should go forward with an accelerated main replacement program, and articulated reasons why it believes an acceleration program is appropriate, most prominent among these public safety concerns. Order at 166-173. Next, the Commission considered whether Peoples Gas had shown that Rider ICR is just and reasonable. After a discussion of applicable legal standards, the Commission concluded that it was "in the position of removing disincentives to the acceleration of system modernization" and that it is acting within its authority under the Public Utilities Act ("PUA" or "the Act"). *Id*. at 178. Concluding that Rider ICR should be approved, the Commission then discussed the terms of the tariff. In particular, the Commission expressed concern that Peoples Gas may not be able to meet its accelerated program's 2030 completion date. *Id*. The Commission also expressed concern about the need to protect ratepayers, finding that certain costs should not be recovered through Rider ICR. *Id.* at 179.

The Commission described its obligation under the Act to balance the needs of ratepayers and shareholders, stating

> It is the Commission's role to balance the needs of this program, which no party refutes, with the additional implementation costs which will be borne by customers. The Commission finds noteworthy the Company's desire to be proactive in updating its infrastructure. In turn, the Commission does not want to impose an additional cost on the public beyond those that are absolutely necessary, especially during these particularly harsh economic times. The Commission must be sure that any additional line item placed on a customer's bill by way of rider recovery will provide an end that is certain. We are sensitive to and again acknowledge the valid concerns of other parties that the Commission not "finance" infrastructure improvements of the Company.

Id. at 179-180.

Remarkably, after acknowledging its obligation to balance the needs of ratepayers and shareholders, the Commission directed Peoples Gas to meet with Staff to determine a baseline for calculating the costs that can properly be recovered under the rider as modified herein. The Company is to file a statement (and accompanying modified tariff language) with the Commission within 60 days of the approval of this Order, outlining how the Company will calculate the portion of the accelerated program that is limited to those costs determined to be beyond the agreed upon baseline. *Id*. at 180.

CUB continues its repeated objections to Rider ICR on legal and policy grounds and will briefly summarize those arguments in this rehearing brief. The record simply does not support approval of Rider ICR at this time. Further, CUB strongly objects to the Commission's decision to delegate its ratemaking authority to Peoples Gas and Staff in determining a baseline for Rider ICR outside the record. This is a clear violation of the Commission's authority and Illinois law and must be reversed.

2. Capital Structure and Short-Term Debt

The Commission's Order is inconsistent with the Commission's own stated policies, which favor actual capital structures over hypothetical ones and which recognize the fungible nature of capital. Instead, the Order offers several stated bases for approval of a hypothetical capital structure which does not incorporate short-term debt and lacks adequate support in the articulated analysis, Commission policy or record evidence.

First, the Order does not provide a complete summary of the relevant evidence. It does not address the fact that Staff and CUB-City each concluded from the evidence of record that the Companies clearly use short-term debt to finance rate base. Order at 92. In fact, Staff was insistent in making that point in connection with its acceptance of the hypothetical capital structure. *Id.* A finding that the "the stronger showing in this case comes from the Utilities and Staff" is entirely dependent on an unwarranted presumption that fungible funds are used in precisely the manner the Utilities claim. This "stronger showing" came only from the Companies' intentions, not their actual practice.

Any conclusion that that fungible money is, in fact, used in whatever fashion a utility might claim ignores Commission precedent that is directly on point and consistent with the burden of proof the Public Utilities Act imposes on utilities in rate cases. 220 ILCS 5/9-201(c). This Commission has held that "[d]ue 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." *Re Ameren Illinois Utilities*, Docket 02-0798 et al. (cons.), Final Order at 67; 220 ILCS 5/9-201(c). The Order does not identify any evidence of record to overcome that rational, intuitively obvious presumption. The Companies' claim prevails only because the Order unilaterally adopts a <u>contrary</u> presumption in the Companies' favor without offering any explanation for its departure from existing Commission policy.

In *Re Northern Illinois Gas Company*, Docket 04-0779, Order (Sept. 30, 2005), the Commission held that is appropriate to exclude short-term debt only "<u>if</u> the utility clearly establishes by a preponderance of the evidence that it is not using short-term debt to finance rate base items." *Docket 04-0779 Order* at 69 (emphasis added). In this case, the Order acknowledges that at least one of the Companies' (revised) rate bases will exceed permanent financing (equity plus long-term debt). Order at 94. The record evidence shows that the Companies do not always have an excess of cash over capital needs. NS-PGL Ex.BAJ-2.0 (Rev.) at 9:162-169. Nor do the Companies dispute either the existence of their short-term debt or their plans to use short-term debt in the test year. NS-PGL Ex. BAJ-2.0 (Rev.) at 7:122-27. The Companies simply claim that they do not use short-term debt to finance rate base, asserting that they use cash to cover any shortfall in covering capital costs. *See* Order at 91.

The determination whether to include short-term debt in the Companies' capital structure directly affects customers' rates and should use the best available, most accurate information. The Commission, therefore, should use the Companies' actual capital structures, including short-term debt, to set rates in this case.

3. Cost of Equity

Contrary to the mandate of the PUA that the Commission take account of the entire record, 220 ILCS 5/10-201(e)(iv), the non-substantive reasons given for the Order's rejection of CUB-City's evidence on the issues have no basis in law, logic, or Commission policy. Equally astonishing is the Order's absolute refusal to take any account of the extraordinary events in the financial markets. Current circumstances in the markets have had direct and significant effects on the operation of the models on which the Commission has traditionally relied and on the cost of equity for relatively low-risk entities like utilities, as investors seek safe harbors in the financial market storms.

The Order found that the use of non-constant growth Discounted Cash Flow ("DCF") models was unsupported in the record but then approved a cost of equity model unsupported by any witness in the case. Order at 125. The Order acknowledge that the Commission must cognizant of the context in which its decisions are made to ensure that the model results presented are generally consistent with real world conditions. Order at 123. There is record evidence that establishes that the relevant financial circumstances are exceptional ones, and that such circumstances do bear directly on the determination of the Companies' cost of equity. *See*, e.g., CUB-City Ex. 2.0 at 3:53, 7:126-133, NS-PGL Ex. SMF-1.0 at 9:174; Staff Ex. 7.0 at 4:84. To ignore such evidence is not consistent with the underlying financial theory that justifies use of the models.

II. ARGUMENT

A. **<u>RIDER ICR</u>**

1. The Commission Unlawfully Delegated Its Ratemaking Authority to Peoples Gas and Staff.

Section 1-102 of the Act provides that one objective of public utility regulation is "the fair treatment of consumers and investors ...." 220 ILCS 5/1-102(d). The Act also provides that in rate cases, it is the Commission's duty to establish just and reasonable rates. 220 ILCS 5/9-201(c). In its Order, the Commission emphasized its obligation to strike the appropriate balance between consumer sand ratepayers, saying "[i]t is the Commission's role to balance the needs of this program, which no party refutes, with the additional implementation costs which will be borne by customers." Order at 179. Yet, immediately after stating it alone could balance these competing needs, the Commission unlawfully delegates its authority to Peoples Gas and Staff. *Id*. at 180.

The Commission's Order makes clear that this task is not simply ministerial: "[We] must be sure that any additional line item placed on a customer's bill by way of rider recovery will provide an end that is certain. We are sensitive to and again acknowledge the valid concerns of other parties that the Commission not 'finance' infrastructure improvements of the Company." *Id*. at 179-180. In other words, the Commission is describing the nuts and bolts of ratemaking – one of the most fundamental reasons for its existence. However, the Commission readily passes its obligation to Staff and Peoples Gas – one of the utilities it is obligated to "regulate[] effectively and comprehensively." 220 ILCS 5/1-102. The Commission has no authority to delegate its ratemaking authority to parties to a case.

The Commission's Order on this point is reminiscent of the Illinois Appellate Court's decision in *Citizens Utility Board v. Illinois Commerce Comm'n*, 275 Ill. App 3d 329 (1995) ("*CUB*"). In that case, the court reversed a Commission Order approving Commonwealth Edison Company's ("ComEd") contract service tariff, Rate CS. Rate CS allowed ComEd to enter into up to 25 contracts with customers that were planning to bypass the ComEd system. *CUB* at 332. Rate CS allowed ComEd to negotiate the rate with the 25 customers, with the only requirement being that the negotiated rate (1) exceeded ComEd's incremental cost of serving each Rate CS customer and (2) contributed to ComEd's fixed costs. *Id*. at 333. Finally, Rate CS required that ComEd file the contracts with the Commission for informational purposes – there was no requirement that the Commission approve each contract, nor would these "proprietary" contracts be subject to public review. *Id*. The court reversed the Commission's Order, finding that, among other things, it violated the rate publication requirements of section 9-102 of the Act. 220 ILCS 5/9-102.

The court also responded directly to ComEd's concerns that Rate CS was necessary for it to deal with competitive pressures it was then facing. *Id*. at 344. While expressing sympathy for ComEd's plight, the court stated that:

> We are ... aware of the special rights and obligations arising from the regulatory compact between the public and investor owned utilities. As part of that compact, utilities must comply with the requirements of the Act and subject themselves to certain constraints, including the filing and publication of rates. Concomitantly, the Commission, as the legislatively appointed guardian of the public's interest, must carry out its statutory mission to approve of only those rates which fully comport with these requirements. ***Otherwise, the regulatory world is turned on its head, as in this case, where the regulated has in effect become the regulator.***

Id. at 344 (emphasis added). Similarly, here the Commission permits Peoples Gas, in consultation with Staff, to establish the terms of Rider ICR instead of carrying out its statutory mission in compliance with its authority under Illinois law.

Because the Commission unlawfully delegated its ratemaking authority to Peoples Gas and Staff, its Order violates sections 10-201(e)(iv)(B) and 10-201(e)(iv)(C) of the Act. 220 ILCS 5/10-201(e)(iv)(B); 220 ILCS 5/10-201(e)(iv)(C).

2. *The Order Violates the Illinois Supreme Court's Prohibition Against Non-Unanimous Settlement Agreements Because the Commission Has Not Made a Finding that the Rider ICR Terms Agreed to by Peoples Gas Are Just and Reasonable.*

As discussed above, the Commission's Order directed Peoples Gas and Staff to meet to "to determine the baseline for calculating the costs that can properly be recovered under the rider as modified herein." Order at 180. No other parties were ordered to or allowed to take part in the Peoples Gas-Staff meeting(s), and therefore no other parties will have input into determining the baseline for Rider ICR recovery. Thus, the Commission's Order essentially directed Peoples and Staff to enter into a non-unanimous settlement agreement.

After having ordered Peoples Gas and Staff to meet to work out the details for the baseline for Rider ICR, the Commission ordered that the utility "file a statement" ... "with the Commission within 60 days of the approval of this Order, outlining how the [utility] will calculate the portion of the accelerated program that is limited to those costs determined to be beyond the agreed upon baseline." *Id*. Then, in its Finding 20, the Commission stated "as required in this Order, under the discussion of Rider ICR, Peoples Gas shall adopt and implement Rider ICR as proposed and with the inclusion of the recommended language changes proposed by Staff and accepted by Peoples Gas[.]" *Id*. at 275. And in its Ordering Paragraphs, the Commission directed that "Peoples Gas shall adopt and implement Rider ICR as proposed and with the inclusion of the recommended language changes proposed by Staff and accepted by Peoples Gas[.] *Id*. at 276. In other words, the Commission determined that it would accept the Peoples-Staff settlement agreement without the participation of other parties in the case and without reviewing whether its terms are just and reasonable.

The Illinois Supreme Court in *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, ("*BPI I*"), 136 Ill. 2d 192 (1989), found that the Commission has the authority to approve non-unanimous settlement agreements only subject to certain, specific conditions. *BPI I* at 217. One such condition is that "the provisions [of the settlement agreement] are independently supported by substantial evidence in the whole record." *Id*. The *BPI I* court noted that its holding regarding non-unanimous settlement agreements mirrored the United States Supreme Court's decision in *Mobil Oil Corp. v. Federal Power Comm'n*, (*Mobil Oil*") 417 U.S. 283 (1974). In *Mobil Oil,* the Supreme Court found that non-unanimous settlement agreements "may be adopted as a resolution *on the merits* if [the Federal Power Commission] makes an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonable' rates ...." *BPI I* at 216, *citing Mobil Oil* at 314 (emphasis in original).

The Order requires only that Peoples Gas file with the Commission the results of its negotiations with Staff. There is simply no way the Commission can conclude – as the *BPI I* case requires – that the non-unanimous settlement agreement is "independently supported by substantial evidence in the whole record." For the same reason, it is not possible that the Commission can conclude that the Peoples-Staff settlement agreement "will establish just and reasonable rates." As such, the Commission's Order violates the Illinois Supreme Court's decision in *BPI I*.

Because the Commission's Order violates the Illinois Supreme Court's proscriptions on non-unanimous settlement agreement established in its *BPI I* decision, the Order violates sections 10-201(e)(iv)(B) and 10-201(e)(iv)(C) of the Act. 220 ILCS 5/10-201(e)(iv)(B); 220 ILCS 5/10-201(e)(iv)(C).

3. The Order's Directive that Peoples Gas and Staff Establish a Baseline is Inconsistent with the Commission's Stated Objectives of Balancing Ratepayer and Shareholder Interests.

As noted above, the Commission emphasized its obligation to balance the interests of consumers and shareholders in establishing a Rider ICR baseline. Order at 179. The Commission also stressed that it did

> not want to impose an additional cost on the public beyond those that are absolutely necessary, especially during these particularly harsh economic times. The Commission must be sure that any additional line item placed on a customer's bill by way of rider recovery will provide an end that is certain. We are sensitive to and again acknowledge the valid concerns of other parties that the Commission not "finance" infrastructure improvements of the Company. Recovery should be limited to those specific costs that are in line with those standards previously outlined.

Id at 179-180. In other words, the Commission wanted to ensure that only the costs associated with the accelerated portion of Peoples Gas main replacement program are recovered through Rider ICR. The Commission found that it was not appropriate to recover Peoples Gas' costs associated with the business-as-usual main replacement scenario through Rider ICR: "We are of the opinion Rider ICR recovery should be reserved only for those incremental costs that exceed the legacy costs and the routine operating and maintenance costs." *Id.* at 179. Unfortunately, the metric Peoples Gas and Staff defined will not ensure that only the accelerated portion of the main replacement program will be recovered through the rider.

On February 16, 2010, Peoples Gas filed a pleading with the Commission setting forth the baseline to which that the utility and Staff had agreed. *In re North Shore-Peoples Gas*, ICC Dockets 09-0166/09-0167 (cons.), Statement of the Peoples Gas Light and Coke Company Regarding the Rider ICR Baseline Pursuant to the Commission's January 21, 2010 Order ("Peoples Gas Baseline Statement") (Feb. 16, 2010). Peoples Gas states that "the baseline for recovery of costs under Rider ICR (i.e., the annual costs forecasted to be incurred for cast iron and ductile iron (CI/DI) main replacement without acceleration of the CI/DI main replacement program to be excluded from Rider ICR recovery) is **$51.85 million**. Peoples Gas Baseline Statement at 2. Subject to other limitations in the rider, any costs Peoples Gas incurs above $51.85 million in replacing mains may be flowed through Rider ICR.

There are several problems with this determination. First, using a dollar value for the Rider ICR baseline does not contemplate changing costs over time. Second, the $51.85 million number developed by Peoples Gas and Staff is a forecasted number and there is no guarantee that the forecast will be remotely accurate. As noted above, Peoples Gas has replaced on average about 45 miles of cast iron and ductile iron mains averaged since 1981. Staff Cross Ex. 20; Aug. 26, 2009 Tr. at 589. Under the replacement program currently in place, completion by the scheduled 2030 end date would require more than 11 times the amount replaced in forecasted 2010, approximately 114 miles per year. AG Init. Br. at 30. There is no evidence that $51.85 million will be sufficient to replace the baseline number of miles of mains next year, five years from now, or any other time between now and 2030, the scheduled end date for the accelerated program. If it turns out that $51.85 million is not sufficient to replace the baseline amount of miles of cast iron and ductile iron mains each year, then ratepayers will end up paying through Rider ICR at least a portion of the non-accelerated main replacement program. Thus, contrary to the Commission's express determination of what it concluded must be avoided, ratepayers will end up "financing" Peoples Gas's infrastructure improvements. Order at 180.

For these reasons, the $51.85 million baseline in Peoples Gas's Baseline Statement does not establish just and reasonable rates and is not supported by substantial evidence. Because of these errors, the Commission's Order violates sections 10-201(e)(iv)(A) and 10-201(e)(iv)(C) of the Act. 220 ILCS 5/10-201(e)(iv)(A); 220 ILCS 5/10-201(e)(iv)(C).

4. Rider ICR is Illegal and Unsupported by Substantial Record Evidence

a. Rider ICR Fails to Conform to the Very Narrow Exceptions to the Rule Against Rate Tracking Mechanisms Like Rider ICR and Illinois Law.

Rider ICR violates the prohibition against retroactive and single issue ratemaking, and violates the PUA's requirement that all rates and other charges be just and reasonable based on used and useful investments. The Company failed to present compelling evidence to demonstrate that a rider is needed to recover costs associated with infrastructure replacement. For these reasons and those stated below, CUB requests that the Commission conduct reconsider its adoption of Rider ICR and issue an Order based on the substantial evidence of record, which compels rejection of the rider. In the alternative, CUB requests that the Commission rehear the issue and take additional evidence.

The PUA requires that all utility rates and charges must be just and reasonable. 220 ILCS 5/9-101. Additionally, any significant addition to existing facilities or plant can only be included in a utility's rate base if the Commission determines that it is both prudent and used and useful in providing utility service to the utilities' customers. 220 ILCS 5/9-212. Rider ICR allows infrastructure costs to be added to rate base before the Commission makes the determination that the plant is prudent, used and useful. Thus, Rider ICR violates these provisions of the PUA by requiring customers to pay for infrastructure that has not been demonstrated to be used and useful or just and reasonable. Section 9-201(c) of the PUA further dictates that "the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility." 220 ILCS 5/9-201(c). The PUA provides for very limited exceptions to the prohibition against single-issue ratemaking.

Illinois courts have upheld strict limitations to the use of rider mechanisms like Rider ICR to protect against single-issue and retroactive ratemaking, and to defend the fundamental principle that rates should be based on a comprehensive test year. The Illinois Supreme Court has set forth specific guidelines for Commission approval of riders that limit the use of these extraordinary ratemaking mechanisms to recovery of "unexpected, volatile or fluctuating expenses" that by their nature do not lend themselves to representative sampling in a single test year. *Citizens Utility Bd. v. Ill. Commerce Comm'n*, 166 Ill. 2d 111, 138-139, 651 N.E.2d 1089 (1995) (rider appropriate for recovery of "uncertain and variable" expenses associated with coal-tar cleanup remediation required by federal statute); *see also A. Finkl & Sons Co. v. Ill. Commerce Comm'n*, 250 Ill. App. 3d 317, 327, 620 N.E.2d 1141 (1st Dist. 1993) ("Riders are useful in alleviating the burden imposed upon a utility in meeting *unexpected, volatile or fluctuating* expenses.") (emphasis in original); *City of Chicago v. Ill. Commerce Comm'n (City of Chicago II)*, 264 Ill. App. 3d 403, 405, 636 N.E.2d 704 (1st Dist. 1993) (rider appropriate "for recovery of costs that are uncertain in duration, timing or amount"); *City of Chicago v. Ill. Commerce Comm'n (City of Chicago I)*, 13 Ill. 2d 607, 150 N.E.2d 776 (1958) (accepting rider to accommodate fluctuating wholesale rates for natural gas).

Illinois courts have permitted riders to recover costs or fees required by statute or ordinance to all ratepayers or a subset of customers. *See Citizens Util. Bd.*, 166 Ill.2d at 138-139*; City of Chicago v. Illinois Commerce Comm'n,* 281 Ill. App. 3d 617, 627 (1st. Dist. 1996) (*City of Chicago III)* (rider recovery of franchise fees to be charged to residents of municipalities assessing the fees did not constitute single-issue ratemaking). *See City of Chicago II*, 264 Ill. App. 3d at 410 ("Rider 28 allows Edison to look to those who cause costs to pay for them.") Additionally, the PUA authorizes surcharges for fuel, environmental remediation, and water and sewage infrastructure costs. *See, e.g.,* 220 ILCS 5/9-220(a), 220 ILCS 5/9-220.1, 220 ILCS 5/9-220.2. Notably, the PUA does not contain a similar infrastructure rider provision for electric or gas utilities. More recently, the Illinois General Assembly authorized rider recovery of energy efficiency program expenses, (220 ILCS 5/8-103(e), 220 ILCS 5/8-104(e)), and incremental bad debt, (220 ILCS 5/19-145). None of these exceptions, however, allow for the recovery of a gas utility's most fundamental infrastructure costs. Rider ICR thus exceeds the Commission's authority under the PUA.

Rider ICR does not address or respond to issues of volatility or uncertainty or costs beyond the control of management. In fact, Peoples Gas does not argue costs under Rider ICR are unexpected or volatile, nor could it, since these costs are well within the control of management. Instead, costs of financing basic infrastructure investment are the most central investment a gas utility can make, considering it is the means by which the utility is able to perform its obligation to deliver natural gas to its customers. In fact, Peoples Gas has an existing CI/DI main replacement program for years, and has been able to undertake this investment - and maintain and "prudently operate" its gas distribution system (PGL Ex.-SDM-1.0 at 9, LL. 176-

177) - without a special rider until now. Nor does Rider ICR fit within any of the statutory or judicially-recognized exceptions allowing rider recovery of specific costs.

b. The Company has Not Substantiated a Need for Extraordinary Rate Treatment.

AG/CUB witness Scott Rubin, as well as Staff witnesses Sheena Kight-Garlisch and Peter Lazare, all agreed the Company failed to prove that Rider ICR is needed or appropriate. Staff witness Kight-Garlisch, for example, noted that the Company identified two other methods that allow “prompt and fair rate recovery” - traditional rate case fillings with a future test year or a deferral mechanism - both of which the Company rejected in favor of Rider ICR. ICC Staff Ex. 8.0 at 22. Ms. Kight-Garlisch testified that the Company provided no analysis to support its need for Rider ICR to raise sufficient capital to provide adequate, efficient, reliable and safe utility service at a reasonable cost. *Id.* Staff witness Lazare was particularly critical of Mr. Schott’s assertion that Rider ICR would somehow “keep the capital costs associated with the infrastructure improvement reasonable.” PGL Ex. JS-1.0 at 14. Mr. Lazare noted that Mr. Schott provided no specific evidence concerning what the capital costs for the program would be with and without Rider ICR. ICC Ex. 9.0 at 4. The Company’s responses to various Staff and AG data requests confirmed this fact. For example, the Company created no financial models to estimate the effects on the company’s financial position, with or without Rider ICR, if it adopted an infrastructure replacement program that ended in 2030, as recommended by PGL witness Salvatore Marano. ICC Staff Ex. 8.0, Attachment B, at 2,-3 and 7.

Peoples Gas could accelerate its program, as desired, without the use of extraordinary rate treatment while maintaining the balanced test year review process. In fact, Peoples failed to show that the existence or absence of Rider ICR would affect its cost of capital, impact its capability to finance necessary improvements, or jeopardize its ability to provide safe and reliable service to its customers. AG/CUB Ex. 3.0 at 4-5. Proof of the shallow ground on which the Commission bases its award of Rider ICR is found in the Company's refusal to commit to any accelerated program, even if Rider ICR is approved by the Commission:

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

Tr. at 61 (Schott).

Further, the rate of return credit proposed by the Company would not protect customers from paying excessive rates. First, the 5% cap built into the rider would increase the allowed dollars under Rider ICR each time rate base grows – i.e. when the utility files a rate case. Second, Mr. Rubin noted that with the magnitude of the accelerated program highlighted in Mr. Marano's testimony, the "cap" would be reached somewhere between every year and every two years for the entire length of the program. Thus, in order for the Company to continue spending money and earning a return on it, as envisioned in the Rider ICR tariff and Mr. Marano's suggested time frame, Mr. Rubin determined that Peoples would need to file rate cases every year or two to reset the base revenue amount built into the 5% cap (further undermining any notion that Rider ICR will reduce the number of rate cases Peoples will file). Tr. at 993. Third, the rate of return credit reduces the authorized rate of return to account for infrastructure investment only when the company is earning more than its authorized rate of return. The credit does not affect excess revenues due to weather or exceptional cost control. Thus, the Company could still earn returns in excess of its authorized rate of return. NS/PG Ex. JFS-3.0 at 5-6, LL. 106-116.

B. CAPITAL STRUCTURE

The Commission's entire reasoning for its adoption of a hypothetical capital structure for the Companies (instead of their actual capital structure) is set out immediately below.

> **4. Commission Analysis and Conclusion**
>
> This Commission has essentially treated short term debt on a case by case basis. We continue to do so today and focus on the facts and circumstances of record at hand.
>
> To reduce issues in this case, Staff 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. In short, Staff sees a small benefit. CUB/City claim that the utilities do not deny that the existence of their plans for using short-term debt in the test year, and, they claim the Companies use their short-term debt to finance rate base. The Utilities assert that they issue short-term debt only temporarily to manage short-term cash flows at certain times, typically at year-end when higher winter revenues have not been collected and season cash requirement are at their highest and in late summer months when revenues are at their lowest. Altogether, the stronger showing in this case comes from the Utilities.
>
> It was claimed that the Utilities must be using short-term debt to finance rate base because their estimated rate bases exceed the long-term capital in their proposed capital structures. This argument proceeds on the notion that if a utility's rate base exceeds its long-term capital, it is using short-term debt to finance rate base. However, this Commission does not necessarily accept this proposition as a foregone conclusion. Further, particular to this case, we are shown that PGL's capitalization is larger than its rate base and North Shore's capitalization is about the same size as its rate base.
>
> Just as significant is that only two years ago, the Commission approved the same capital structure that the Utilities propose in this case; the record shows no difference between how the Utilities use short term debt today and how they used it at that time.
>
> For these reasons, the Commission finds a capital structure of 0% short-term debt, 44% long-term debt, and 56% common equity to be appropriate for both Peoples Gas and North Shore.

Order at 93.

The Commission declares a case-by-case approach to this issue is customary to unlawfully bypass pertinent Commission rulings and practices, and to ignore the record evidence. While factual findings are necessarily case-by-case, the relevant Commission rulings are not variable from case to case. They are matters of Commission policy intended to bring consistency to its decisions in precisely the circumstances at hand. Indeed, the Commission emphasized the importance of such consistency in the Companies' most recent prior case:

> . . . Commission action brings certainty to a situation and settles expectations. This is another way of saying that unless there are clear and distinguishable reasons for deciding a case differently, the Commission will follow in line with precedent.

Re North Shore Gas Company, Dkt. 07-0241, Order (Feb 5, 2008) at 16.

The Order's conclusion is inconsistent with the Commission's established practice to (a) require proof of actual (not theoretical or intended) uses of short-term capital, (b) reject unproven claims that deny the fungible nature of funds, and (c) disfavor hypothetical capital structures. The Companies' testimony of claimed intentions and of forecasts respecting possible uses of funds does not satisfy the requirement that a utility "clearly establishes" its actual uses of short-term debt funds.

The evidence of record does not support the Order's conclusion that the Companies do not use short-term debt to finance rate base. The Order finds that "the stronger showing in this case comes from the Utilities." Only the Companies assert that the evidence supports that finding. All other testimony supported the opposite conclusion. Staff and CUB-City concluded from the evidence of record that the Companies, in fact, do use short-term debt to finance their rate bases. Order at 91-92. The evidence the Companies present addresses only their claimed <u>intentions</u> for the use of short-term debt funds. CUB Init. Br. at 12. No hard evidence respecting the Companies' <u>actual</u> use of short-term debt supports their claim that the funds, in fact, are not used to finance their rate bases.

1. The Record Evidence Does Not Support the Commission's Capital Structure.

The Companies do not dispute either the existence of their short-term debt or their plans to use short-term debt within the test year. Order at 90. The Companies also do not deny that their individual capital needs sometimes exceed their long-term capital funds, in short, that sometimes rate base exceeds permanent financing sources. *Id.* Experts for both CUB-City and Staff testified that the available evidence indicates that the Companies clearly use short-term debt to finance rate base. *See* Order at 91-92.

Staff's decision to support a hypothetical capital structure that does not reflect the Companies' actual use of short-term debt was emphatically result-oriented and not dictated by the evidence of record. *Id.* at 91. Specifically, Staff concluded that use of the Companies' proposed hypothetical capital structure (instead of their actual capital structures that include short-term debt) produced a lower overall rate of return for the Companies, something that yields a small comparative benefit for ratepayers. *Id.* For that reason, Staff accepted the less precise hypothetical capital structure while emphasizing that the Companies do use short-term debt to finance its rate base. *Id.* However, as Staff noted, because short-term debt and other sources of capital have distinctive costs, the use of a hypothetical capital structure produces a calculated cost of capital that differs from the Companies' actual costs.

Opposing this evidence is only the Companies' <u>claim</u> that they do not use short-term debt to finance rate base. They assert that they use cash to cover any shortfall in long-term capital needs. Order at 90-91. In essence, the Companies' position is that they had cash to cover their seasonal expenses, but chose nonetheless to issue short-term debt for those expenses and to fund any long-term capital needs with cash. (As noted, the evidence that they are not consistently capable of doing so is uncontested.)

2. The Order Abandons, Without Explanation, Several Established Commission Policies or Practices Pertinent to This Issue.

The Order unlawfully abandons, without explanation, several pertinent Commission practices, *i.e.*, expressed policies that have been applied in contested case decisions. Most prominently, the Commission abandons -- without acknowledgment or explanation -- explicitly defined evidentiary requirements for a utility to establish its use of fungible capital, and short-term debt in particular.

The Commission has expressly held that "[d]ue 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." *Re Ameren Illinois Utilities*, Docket 02-0798 et al. (cons.), Order (Oct. 22, 2003) at 67. Observing the utility's statutory burden of proof, the Commission decision in that case found a failure of proof by the utility, not by parties opposing its claims. In other words, the mere identification of some limited, theoretically <u>possible</u> non-rate base uses does not establish a utility's <u>actual</u> use of short-term debt. At most, such differences would show possibilities for use of capital, rather than actual uses of capital.

Instead, it is appropriate to exclude short-term debt "<u>if</u> the utility clearly establishes by a preponderance of the evidence that it is not using short-term debt to finance rate base items." *Docket 04-0779 Order* at 69 (emphasis added). The Commission's evidentiary requirements in considering a utility's contention that it used short-term debt to finance non-rate base activities, the same assertion the Companies make here, are consistent with its established policy on fungible capital. In its more recent decision in *Re Northern Illinois Gas Company*, ICC Docket No. 08-0363, Order on Rehearing (Oct. 7, 2009) ("*Docket 08-0363 Order*"), the Commission concluded that testimony offered by the utility describing the scope of its non-rate base activities was insufficient to establish that the utility actually applied the short-term debt to the uses described. *Docket 08-0363 Order* at 8.

Inconsistently, this Order finds it sufficient that “[t]he Utilities <u>assert</u> that they issue short-term debt only temporarily to manage short-term cash flows at certain times . . . .” Order at 93 (emphasis added). In this record, the Companies offered only testimony about their <u>intentions</u> for the use of short-term debt and no evidence to support their claims about the <u>actual</u> use of the funds. For example, there was no evidence of accounting constraints or earmarking protocols that would enforce the claimed internal constraints on their use of short-term debt funds.

Under these established policies and practices, it is clear that the Companies have not satisfied their burden of proof and that the record does not support the Commission’s conclusion. Without explanation, the Order departs from plainly stated policies on fungible funds (“this Commission does not necessarily accept this proposition as a foregone conclusion”) and the required proof to establish a utility’s use of short-term debt. *See* Order at 93. That action is outside the Commission’s authority, as defined by Illinois’ Supreme Court. *Business & Professional People v. ICC*, 136 Ill. 2d 192 (1989) at 225-226. In that case, the Illinois Appellate Court was clear that the Commission could alter or amend its past practices only where it defines a new standard clearly at the beginning of a contested case proceeding. *Id.* Moreover, the Commission had to identify the circumstances or evidence relevant under the new standard is established. *Id.* The Commission must either abide by the prior standard, or set an articulable alternative standard which the parties and intervenors could follow. *Id.*

The Order also deviates from the Commission’s established regime of test year, cost-based ratemaking. There is no acknowledgment of the inevitable result of using hypothetical rather than actual capital costs -- *viz.*, non-cost-based rates. As the Companies pointed out, the

Commission has previously stated that "imputing a hypothetical capital structure to determine a utility's rates is a serious adjustment, and should only be adopted when a utility's actual capital structure is found to be unreasonable, imprudent, or unduly affected by such circumstances as double leverage so as to unfairly burden the utility's customers." NS-PGL Ex. BAJ-2.0 at 4, *citing* Docket No. 87-0032, Order (Jan. 20, 1988) at 26. The Companies' claim prevails only because the Order adopts a novel contrary presumption that favors the Companies' unsupported claims over the fungible nature of the funds at issue and because the Order unilaterally lowers the Commission's explicitly defined standards of evidentiary proof. Contrary to the requirements of governing case law interpreting the statutory procedural requirements that constrain the Commission's actions, the Order again fails to offer an explanation for its departures from existing Commission policy. *Business & Professional People v. ICC*, 136 Ill. 2d 192 (1989) at 225-226.

3. The Order Violates Applicable Provisions of the Public Utilities Act.

In addition, the Order violates several provisions of the PUA. The PUA expressly requires that delivery services rates be cost-based. 220 ILCS 5/16-108(c) ("Charges for delivery services shall be cost based . . . ."). The Order deviates from cost-based ratemaking by deliberately ignoring the known, distinctive costs of the Companies' short-term debt. The manifest weight of the record evidence shows that the capital structure approved by the Order does not reflect the actual costs of the capital use to finance the Companies' rate bases.
The Order's acceptance of a result-oriented determination of the Companies' cost of capital violates that clear requirement. Even though, as Staff pointed out, the hypothetical capital structure in this case results in lower costs for ratepayers, using a hypothetical approach remains unlawful (and unlikely to benefit ratepayers consistently).

In concluding that the Companies have met their burden of proof under the Commission evidentiary requirements and the PUA, the Order reasons (at 93):

> Just as significant is that only two years ago, the Commission approved the same capital structure that the Utilities propose in this case; the record shows no difference between how the Utilities use short term debt today and how they used it at that time.

This reasoning uses a presumed prior factual finding from a different record as a basis for the decision in this case. *But see Re North Shore Gas Co., et al.,* Dkt. 07-0241/07-0242 (cons.) Order (Feb 5, 2008) at 73 (use of short term debt not a contested issue in that case). The Order's reliance on the record of a prior case is not permitted by the PUA. "[A]ny finding, decision or order made by the Commission shall be based <u>exclusively</u> on the record for decision in the case." 220 ILCS 5/10-103 (emphasis added). Further, the Order requires parties opposing the Companies' proposal to demonstrate that there is a difference the Companies' prior use of funds -- instead of requiring the utility to prove how it currently uses short-term debt funds and that such use supports its proposed capital structure. That is an unlawful reversal of the burden of proof expressly defined by the PUA. "[T]he burden of proof . . . in whole and in part, shall be upon the utility." 220 ILCS 5/9-201(c).

The Order's implicit finding that the Companies do not use short-term debt funds for rate base is not proved by a preponderance of the evidence; indeed, it is against the manifest weight of the evidence. The Companies present only bare allegations of their intentions and suggest that it might be possible to avoid use of short-term funds for rate base, under certain circumstances and for short periods of time, through questionable uses of cash and short-term debt funds. There is <u>no</u> evidence of corporate policies, accounting regimes or other measures to implement the strict control of fungible funds that the Companies claim. Under the PUA's assignment of the burden of proof, the absence of any evidence showing how the Companies <u>actually</u> use their short-term debt requires a finding against the Companies. Especially in light of the Commission's position on the treatment of fungible capital, the Companies' position is not supported by substantial evidence of record. *See* 220 ILCS 5/10-201(e)(iv)A.

The Commission's finding that the Companies, in fact, do take out of short-term loans that (according to the Companies) are not needed demonstrates a separate violation of the PUA. The added expense of using short-term debt for expenses the Companies claim to have cash available to cover is not a prudently incurred or just and reasonable cost. Such costs are not recoverable from ratepayers. *See* 220 ILCS 5/9-101.

Each of these deviations from established Commission practice without explanation is also a violation of its duty to provide adequate articulation of the Commission decision making. *See* 220 ILCS 5/10-201(e)(iii); *Business & Professional People v. ICC*, 136 Ill. 2d 192 (1989) at 225-226.

C. COST OF COMMON EQUITY

The Order approves a cost of equity which is based on models not supported by any witness, on a rejection of any models which differed from those of Staff or the Companies, and on an erroneous conclusion that the use of non-constant growth DCF models was not supported in the record. Order at 125. These Commission actions embody multiple violations of law.

1. The Order's Rejection of Non-Constant Growth DCF Models and Reliance on Constant Growth Models Using Analysts' Growth Projections are Against the Manifest Weight of the Evidence.

Concerning the use of particular cost of equity models in the relevant financial circumstances, the Order acknowledges (a) that "we [the Commission] must be cognizant of this context because each of the financial models is theoretical and has its own limitations," and (b) that "their limitations require that we also consult general financial market information to ensure that the model results presented us are generally consistent with real world conditions." Order at 123.

Yet, the Commission gave no weight to the evidence it described as essential to its determinations. The Order concludes: "In the case at hand, however, we find Staff's use of the non-constant DCF model to be unsupported by the evidentiary record." *Id.* at 124. This is despite evidence in the record that establishes exceptional financial market circumstances that bear directly on the determination of the Companies' cost of equity. *See, e.g.*, CUB-City Ex. 2.0 at 3:53, 7:126-133, NS-PGL Ex. SMF-1.0 at 9:174; Staff Ex. 7.0 at 4:84. The Commission also ignores the overwhelming evidence that the use of constant growth models in this market environment is inconsistent with the financial theory justifying the use of a DCF model. CUB Init. Br. at 15-16. Even the Companies' expert acknowledged this, PGL Ex. 1.0 Rev. at 30-31:642-670, though he deliberately ignored those constraints of the underlying theory in calculating the results on which the Commission relies. His expert opinion thus lacks the *bona fides* of a basis in accepted scientific theory that is required of expert opinions by Illinois law. That estimate should be given no weight. *People v. McKown*, 226 Ill. 2d 245, 247 n.2 (Ill. 2007). Despite uncontradicted testimony by every cost of equity expert that the relevant financial market circumstances are extraordinary, the Commission wrongly concludes that it must ignore those circumstances to replicate constant growth analyses used for less turbulent markets.[4]

[4] Moreover, the Order ignores this evidence completely when it concludes there is not "sufficient explanation of what circumstances in the current case would warrant such a preference" for a non-constant growth DCF model over a constant growth DCF model. Order at 125.

The Commission rejects the results of any non-constant growth DCF model. "[W]e find Staff's use of the non-constant DCF model to be unsupported by the evidentiary record.[5]" The Commission's reasoning that "we reject Staff's position that the non-constant growth form of the model must be used <u>any time it can be claimed that analyst growth rates are not sustainable</u>" is an easily attacked straw man that does not accurately present Staff's actual position or argument for purposes of appellate review. Order at 125 (emphasis added).

After reciting some of Staff's reasons for using a non-constant DCF model (and ignoring CUB-City's), the Commission found that "Staff, however, was unable to demonstrate the unsustainability of the analyst growth rates it relied on . . . ." Order at 124. The Commission, however, has resolved that issue. *Docket 08-0363 Order* at 69. This is a finding that does not depend on the identity of the utility, and it does not vary from case to case. Moreover, the burden of proof rested with the Companies to show that the analysts' growth rate forecasts were sustainable and appropriate in a constant growth DCF model. CUB Init. Br. at 12-13; 220 ILCS 5/9-201(c). The Companies did not make those showings.

As to the additional record evidence compelling rejection of constant growth models and analysts' short-term forecasts as long-term growth inputs, the Commission gives no indication that it even considered that evidence from CUB-City. The CUB-City evidence is more extensive than Staff's, is unchallenged in the record, and addressed matters other than the single issue on which the Commission rejects Staff's evidence as inadequate. See CUB Init. Br. at 13-44; CUB Reply Brief at 4-21. CUB-City's evidence demonstrated that the relevant financial circumstances require the use of non-constant growth models with sustainable growth inputs. Contrary to the PUA mandate the Commission take account of the entire record, the non-

[5] Presumably, the Commission would make the same finding for CUB-City's non-constant growth DCF model, but CUB-City's results were already excluded from the Commission's analysis for a different, equally unlawful, reason.

substantive reasons given for the Order's refusal to even consider CUB-City's evidence have no basis in law, logic, or Commission policy. 220 ILCS 5/10-201(e)(iv)A.

If the Commission purports to have considered that evidence, then its findings that constant growth models are appropriate in the relevant financial circumstances and that "Staff . . . was unable to demonstrate the unsustainability of the analyst growth rates it relied on" are contrary to the manifest weight of the evidence. 220 ILCS 5/10-201(e)(iv)A. In any case, the clarity in articulated reasoning required by 10-201(e)(iii) is lacking in the Commission's Order.

2. The Commission Based Its Cost of Equity Determination on Calculations That Lack Record Support.

The cost of equity estimates that the Commission relies upon were generated <u>in the Commission's Order</u> from excerpts of analyses that the experts in this case expressly rejected. Central to the Order's analysis is an orphan DCF estimate that was developed using an assumption that utilities' growth will be constant at current, high forecast rates, forever. The Commission finds that "it is clear in the evidentiary record that <u>had</u> Staff applied a constant growth DCF, it would result in an estimate of 11.76%." Order at 125. The Commission thus attributes to Staff a <u>calculation</u> – not an analysis or recommendation – that is that is at odds with the judgment of Staff's own witness, Michael McNally. In fact, Mr. McNally expressly rejected the use of a constant growth model in the financial circumstances shown in the record. CUB-City Reply Brief on Exceptions at 5. Mr. Moul, who performed a constant growth DCF analysis, explicitly rejected the validity of that figure, testifying that it "cannot be used" without the upward adjustments he detailed in his testimony. NS-PGL Ex. PRM-1.0 at 18:380-197. That pseudo-evidence is supported only by the Commission in its Order.

Instead of looking to the expert testimony in the case, the Commission relies on its authority to play a substantive role in ratemaking matters. Pointing to the legislative nature of ratemaking, the Order declares that "the Commission has acted properly in developing its own cost of equity for the Utilities." Order at 123. As CUB-City pointed out in their briefs, the constraints of the PUA mean that the Commission is <u>not</u> permitted to rely upon improper or non-record information. As the Order concedes, the Commission is constrained in its substantive actions by the record evidence and the PUA's requirement that Commission decisions be supported by that same record evidence. Order at 123. The Commission <u>cannot</u> rely on unsupported extracts, intermediate results or re-calculations that are expressly disavowed by witness who performed the calculation. The Order's conclusions are not supported by the record evidence in this case, and reliance on such improper information is unlawful, violating the PUA's requirement that decisions be based exclusively on proper record evidence. 220 ILCS 5/10-103.

Separately, the Commission uses the fact that some experts in this case changed the models they used from prior rate case proceedings as a basis for rejecting what is -- according to the expert witnesses in the case -- the more appropriate non-constant growth analysis in the unique financial circumstances of this case. *See, e.g.,* CUB-City Ex. 1.0 at 3, LL 27-31. The Order refused to accept even the possibility that financial circumstances the Companies themselves described as the most serious since the Great Depression (PGL BOE at 39) could require the use of estimation models that do not require settled financial markets like those relevant in prior cases. The Order's reliance on prior records is a violation of the PUA's requirement that decisions in this case be based on only the record in this case. 220 ILCS 5/10-103.

Instead of examining the evidentiary merits of the cost of equity recommendations of record, the Commission uses a selective mix of unsupported extracts from experts' actual analyses and recommendations, makes findings based on the proximity or popularity of estimates and approaches, and employs new, subjective criteria for assessing the relevance of market data - instead of assessing the merits of the evidence and analyses supporting parties' cost of equity estimates. The effect is to maintain higher than justified returns for the Companies. The Commission does not identify any supporting legal authority or any unaltered evidence of record to support its actions. The Commission extended the reach of these novel approaches even to inputs into estimation analyses. Order at 126-127.

The only permissible inquiry is whether the use of a particular model is justified in the circumstances established by the evidence of record, not what was supported by or approved on a different record in a different case. The Commission Order assumes, without any basis in the evidence of this record, that the constant growth model used to estimate the cost of equity in past, more normal circumstances is required in the chaotic markets of the "[worst crisis since the depression]." PGL BOE at 39. The record in this case establishes without contradiction that current circumstances in the markets have had direct and significant effects on the operation of the models on which the Commission has traditionally relied, as well as on the cost of equity for relatively low-risk entities like utilities. The Commission's rejection of the more appropriate non-constant growth DCF models is not a decision based exclusively on the record in this case, and such constitutes reversible error. 220 ILCS 5/10-201(e)(iv).

3. *The Order's Exclusion of CUB-City's Analyses From Consideration is Arbitrary and Precludes a Decision on the Entire Record.*

Without examining the merits of the testimony of CUB-City experts, and irrespective of the supporting evidence, the Commission used the simple fact that CUB-City's analysis inputs and results were different from others in the case to exclude those analyses from consideration in determining the Companies' cost of equity. Not only is the Commission's use of a "difference" criterion to screen record evidence unlawful, the Commission's selective and inconsistent application of the criterion is arbitrary and also unlawful. The Commission's analysis that had the consistent effect of excluding the different (lower) costs estimates of CUB-City's expert.

The Commission resolves a fundamental question – whether a market risk premium should be derived from academic studies of market performance or calculated for a particular situation – by a proximity analysis, i.e., seeing where most of the numbers come out and excluding outliers: "Given the disparity between Mr. Thomas' estimate and the results produced by Staff and the Utilities, we will not consider CUB/City's estimate." Order at 127.

8.58%	< 9.00%	9.69%	9.79%	10.15%	11.87%
|	|	|	|	|	|
Thomas	Bodmer	(PGL) McNally	(NS)	*2009 Gas Average - Other Commissions*	Moul

Astonishingly, the Proposed Order gives <u>no</u> consideration to any element of the 8.58% and < 9.00% estimates from CUB-City, but gives equal weight to the 9.69 and 9.79 estimate analyses of the Staff and its treatments of pieces of the analyses producing the clear outliner estimate of 11.87% from the Companies' Mr. Moul. Contrary to the mandate of the PUA, the Commission did not analyze the data or consider the potential for bias in "estimates calculated for particular situations." Order at 127. There is no legal authority or Commission precedent for decisions that give primacy to proximity of results, or even the popularity of one approach over another. Instead the PUA calls for an articulated, reasoned analysis of the evidence of record. CUB-City do not suggest that the Commission cannot develop a cost of equity analysis or estimate. The problem is the Commission is restricted to the credible and lawful evidence of record and lawful, reasoned and articulated decision making processes.

The Commission cannot rely on unsupported extracts, intermediate results or re-calculations that are expressly disavowed by the expert the Order names as the author, on a record that is unlawfully shrunk by arbitrarily applied, novel tests that have no substantive content or legal basis, or on estimates derived using methodologies that assume the absence of the market turmoil shown by the manifest weight of record evidence. These actions constitute violations of 220 ILCS 5/10-201(e)(iii) and 220 ILCS 5/10-201(e)(iv).

III. CONCLUSION

The Commission unlawfully exceeded its authority in approving Rider ICR and in directing Staff and the Company to negotiate a "baseline" outside of the record. Peoples Gas has failed to demonstrate a need for the extraordinary rate treatment in lieu of filing traditional rate cases. Rider ICR provides for excessive returns for the Company, unlawfully switches the Company's nuts and bolts financing risk to customers and unreasonably increases customer costs. For all these reasons and those stated above, CUB requests that the Commission reverse its decision to approve Rider ICR. Because the record compels such a result, the Commission need not accept additional evidence to make this determination. If, however, the Commission declines to deny Rider ICR, it must, at a minimum, accept additional evidence to determine the baseline amount, in order to avoid reversal.

The Order commits reversible error by relying on a hypothetical capital structure and unsupported cost of equity models. The Commission's Order is inconsistent with the Commission's own stated policies, which favor actual capital structures over hypothetical ones and which recognize the fungible nature of capital. Instead, the Order offers several stated bases for approval of a hypothetical capital structure which does not incorporate short-term debt and lacks adequate support in the articulated analysis, Commission policy or record evidence. Contrary to the mandate of the PUA that the Commission take account of the entire record, 220 ILCS 5/10-201(e)(iv), the non-substantive reasons given for the Order's rejection of CUB-City's evidence on the issues have no basis in law, logic, or Commission policy. Equally astonishing is the Order's absolute refusal to take any account of the extraordinary events in the financial markets.

WHEREFORE, for the reasons stated herein, CUB respectfully requests that the Commission reject Peoples Gas' proposed Rider ICR, adopt a capital structure based upon the Companies' actual capital structure as presented in the record, and adopt a cost of equity based on

Respectfully submitted,

CITIZENS UTILITY BOARD

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