STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	**:**	
	:	**09-0166**
Proposed general increase in natural gas rates. (tariffs filed March 25, 2009)	**:**	
	:	
The Peoples Gas Light and Coke Company	**:**	**09-0167**
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ORDER ON REHEARING

________________ ___, 2010

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<u>ORDER ON REHEARING</u>

By the Commission:

I. BACKGROUND:

On February 25, 2009, The Peoples Gas Light and Coke Company ("Peoples Gas" or "PGL") initiated a proceeding pursuant to Section 9-201 of the Public Utilities Act (the "Act"), 220 ILCS 5/9-201, for a general increase in natural gas rates. PGL's tariff filing included a proposed new Rider – Rider ICR – for the recovery of costs related to a possible acceleration of PGL's main replacement program in order to enable the acceleration of that program. In its January 21, 2010 Order, the Illinois Commerce Commission (the "Commission") authorized Rider ICR as proposed by Peoples Gas with the modifications proposed by the Staff of the Illinois Commerce Commission ("Staff") accepted by Peoples Gas. Further, in its Order, the Commission ordered that a "Baseline" provision be added to Rider ICR in order to exclude "ongoing legacy costs from [PGL's] 50 year plan" and "routine operating and maintenance costs associated with those forecasted costs" from recovery under Rider ICR. (Order at 179.) The Commission's Order directed that PGL and Staff seek to agree on what the Baseline should be and that Peoples Gas file a statement within 60 days outlining how recovery of costs under Rider ICR would be limited to those determined to be beyond the agreed upon Baseline. *Id*.

Pursuant to the Commission's Order, Peoples Gas and Staff met to determine a Baseline intended to comply with the Commission's directions and that already had support in the existing evidentiary record. An agreement was reached. On February 16, 2010, Peoples Gas filed its Baseline Statement and revised the Rider ICR tariff, implementing the Baseline agreed upon by Staff and PGL.

The Attorney General of the State of Illinois (the "Attorney General" or "AG"), the Citizens Utility Board ("CUB"), and the City of Chicago (the "City") each filed applications for rehearing which, among other things, requested that the Commission grant rehearing with respect to the procedure it had directed for the determination of the Rider ICR Baseline on several grounds, including that it improperly failed to allow other parties or intervenors an opportunity to participate in that determination or challenge the Baseline determined by PGL and Staff, in violation of the contested case provisions of Section 10-201 of the Act, 220 ILCS 5/10-201. These parties also argued that the agreement between Staff and PGL on the Baseline was a partial settlement without unanimous agreement of all parties and thus, required the Commission to make an independent finding, supported by substantial evidence in the record as a whole, that the proposal would establish just and reasonable rates, citing *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n,* 136 Ill. 2d 192, 217 (1989).

While denying rehearing on all other issues raised in the various parties' and intervenors' applications for rehearing, on March 10, 2010, the Commission granted the AG, CUB, and City applications for rehearing limited exclusively to the determination of the Rider ICR Baseline.

II. PROCEDURAL HISTORY ON REHEARING

On March 23, 2010, with due notice having been given, the Administrative Law Judges (the "ALJs") held a status hearing, at which time a schedule was adopted for the conduct of the rehearing, and the matter was continued to May 6, 2010 for an evidentiary hearing.

Pre-Hearing Testimony.

On April 8, 2010, PGL filed the direct testimony of Christine M. Gregor, Director - Operations Accounting for The Peoples Gas Light and Coke Company, and Salvatore D. Marano, Managing Director for Jacobs Consultancy Inc.'s ("Jacobs") Utilities Practice.

On April 22, 2010, Staff filed the direct testimony of Dianna Hathhorn, Accountant, Accounting Department, Financial Analysis Division.

No further pre-hearing testimony was filed by any party.

The Evidentiary Hearing.

The evidentiary hearing was held on May 6, 2010 at the offices of the Commission in Chicago, Illinois. At the evidentiary hearing, appearances were entered by PGL, Staff, the AG, CUB, the City, and Interstate Gas Supply of Illinois, Inc. ("ISG") as a member of the Retail Gas Suppliers (an ad hoc group comprised of Dominion Retail, IGS, and Prairie Point Energy, LLC, d/b/a Nicor Advanced Energy, LLC).

All parties were given the opportunity to cross-examine witnesses. No parties, however, wished to cross examine the witnesses who had filed pre-hearing testimony, so the testimony of Christine M. Gregor and Salvatore D. Marano on behalf of PGL and Dianna Hathhorn on behalf of Staff were entered into the record via affidavit.

Further, PGL and the AG stipulated to the admissibility of PGL's response to AG data request AG 2.01, which was entered into the record as AG Cross Ex. 1 on Rehearing. No party objected to its admission.

On May 6, 2010, the ALJs marked the record "Heard and Taken".

Post-Hearing Briefs.

On May 11, 2010, the AG filed an Initial Brief for purposes of preserving its right to challenge the Commission's authorization of Rider ICR on appeal.

On May 17, 2010, PGL, Staff, CUB and the City submitted a draft Agreed Proposed Order. While not joining in its filing, the AG did not contest the draft Agreed Proposed Order.

III. The Baseline Proposed by Peoples Gas and Response of Other Parties/Intervenors

A. Peoples Gas Position

With respect to the Commission's direction that Rider ICR not recover routine operating and maintenance costs associated with the forecasted costs of its legacy plan, PGL witness Christine M. Gregor, Director - Operations Accounting for Peoples Gas, testified that operating and maintenance costs will not be recovered through Rider ICR.

PGL witness Salvatore D. Marano, Managing Director, Jacobs Utilities Practice, presented Peoples Gas' proposal for a Rider ICR Baseline designed to meet the Commission's direction that "ongoing legacy costs from [PGL's] 50 year plan" not be recovered under Rider ICR.

Determining the "50 Year Plan"

Mr. Marano first testified as to what he believed the Commission meant by its reference to PGL's "50 year plan." Mr. Marano testified that this appeared to be a reference to his earlier testimony in the proceeding in which he presented a cost analysis of PGL's current legacy cast iron/ductile iron ("CI/DI") replacement plan showing that with the legacy plan's target replacement rate of 45 miles of CI/DI main per year, the replacement of all of PGL's existing CI/DI main would be completed by the year 2059, or, in other words, 50 years from the year in which he had presented his testimony (2009 to 2059 = 50 years).

Mr. Marano testified that the legacy 50 year plan described in his earlier testimony assumed a planned replacement rate of 45 miles per year based upon Jacobs' review of records and discussions with PGL's Operations group. In 1993, PGL commissioned ZEI, Inc. ("ZEI") to perform a study to update an earlier study on CI/DI main replacement conducted in 1981 by a predecessor company, Zinder Engineering Inc. ("Zinder"). Based on PGL's database of maintenance activities and field analysis, ZEI concluded that a slower replacement rate than recommended by the earlier Zinder report was appropriate. Based upon the recommendations of ZEI's 1993 report, PGL adopted a target rate for the replacement of CI/DI mains of approximately 45 miles annually subsequent to 1993.

In 2002, ZEI performed a supplemental study on PGL's CI/DI main replacement program, which concluded that PGL's plan to retire approximately 45 miles of CI/DI main per year was appropriate. Accordingly, PGL continued to target replacement of approximately 45 miles of CI/DI main per year.

Mr. Marano further testified that based upon review of records and discussions with Gas Operations, PGL currently utilizes methods and systems to analyze and select potential distribution system capital improvement projects, based on a combination of pipe history and situational factors (i.e., the Main Ranking Index, or "MRI"), as well as its Cost Optimization Program ("COP"). The methodology for project selection ranges from the highest potential projects to improvement recommendations from PGL's general supervisors based on their knowledge of distribution system weaknesses in their territories to projects based on coordination with public improvement projects. The driver, however, for determining the location and scope of these projects primarily has been the goal of replacing approximately 45 miles of CI/DI pipe each year in the most effective manner possible.

Accordingly, Mr. Marano concluded that with this established annual replacement target of 45 miles, PGL's pre-existing main replacement program would not be completed until the year 2059 -- 50 years after this proceeding was initiated in 2009.

Rider ICR Baseline

Mr. Marano testified that in his opinion, the appropriate data to use as a baseline for Rider ICR is the cost (Nominal Dollars) based on the 2011 Total Construction Cost as shown in Scenario 2 of the Cost Benefit Analysis Model he presented in his previous testimony (Peoples Gas Exs. SDM-1.0 Rev. at 56 and SDM-1.18 Rev.). This figure represents the spending level that Jacobs calculated based on PGL's 50 year plan. Mr. Marano testified that this calculation was the result of a bottom-up analysis of the total construction cost for PGL's legacy CI/DI replacement plan by examining and determining its underlying cost elements.

In his testimony on rehearing, Mr. Marano presented an Exhibit SDM-4.1, which was an extract from his Cost Benefit Analysis Model showing the Total Construction Cost and a cost breakdown for year 2011 in both real and nominal dollars. The year 2011 was chosen as the base year because it is the starting year of the approved Rider ICR. The following is Mr. Marano's Exhibit SDM-4.1:

Exhibit SDM - 4.1 - Total Construction Cost Baseline

Scenario 2 -- Current	**2011 (2010 Real Dollars)**	**2011 Baseline (Nominal Dollars)**
Main Replacement Cost	$26,212,470	$26,684,294
Installation of PL Main	$18,540,469	$18,874,197
Installation of ST Main	$2,263,678	$2,304,424
Restoration Cost	$5,408,323	$5,505,673
Service Replacement Cost	$13,756,749	$14,004,371
Installation of Services	$10,731,692	$10,924,863
Restoration Cost	$3,025,057	$3,079,508
Meter Replacement Cost	$2,798,832	$2,849,211
House Regulator Cost	$1,399,416	$1,424,605
Cost to Abandon Regulator Stations	$172,606	$175,713
New Regulator Stations	$135,083	$137,515
New City Gate Stations	$0	$0
Total Construction Cost*	**$44,475,156**	**$45,275,708**
* Total Construction Cost difference in sum of 2011 Baseline (Nominal Dollars) is due to rounding		

Accordingly, Mr. Marano concluded that the Rider ICR Baseline initially should be set at $45,275,708 in 2011. Mr. Marano further testified that an escalation factor should be included in the baseline so that the baseline cost of $45,275,708 is adjusted annually in years subsequent to 2011 to account for changes in material and labor costs in subsequent years.

Mr. Marano testified that the Handy-Whitman Index® of Public Utilities Construction Costs™, Cost Trends of Gas Utility Construction Gas Construction Index for the North Central Region should be used for the cost escalation factor of the Rider

ICR Baseline. Not only is the Handy-Whitman Index® published by an independent third-party and has been accepted and approved by the Commission because it is utility industry specific[1], it provides separate construction cost indices for gas plant accounts associated with PGL's main replacement program.

Mr. Marano proposed that a weighted index for total construction cost be determined annually using the gas plant accounts. Mr. Marano provided an Exhibit SDM-4.2 that used the Handy-Whitman Index® for January 2009 to illustrate the methodology and its application in future years:

Exhibit SDM - 4.2 - Total Construction Cost Weighted Index Illustration

Construction Cost Elements	Baseline Cost	Plant Account No	Index Weighting Factor	H-W Cost Index	Weighted Component
Main Replacement Cost	$26,684,294	[redacted]			
Installation of PL Main	$18,874,197	376	41.69%	493	205.53
Installation of ST Main	$2,304,424	376	5.09%	682	34.71
Restoration Cost *	$5,505,673	376	12.16%	514	62.50
Service Replacement Cost	$14,004,371	[redacted]			
Installation of PL Services	$10,924,863	380	24.13%	492	118.72
Restoration Cost	$3,079,508	380	6.80%	492	33.46
Meter Replacement Cost	$2,849,211	381	6.29%	261	16.42
House Regulator Cost	$1,424,605	383	3.15%	412	12.98

[1] *See*, *e.g.*, *Illinois-American Water Co.*, ICC Docket No. 08-0768, at 7 and 10 (Order, July 8, 2004); *Northern Illinois Gas Co.*, 1996 WL 34370337 at 16 (Order, April 3,1996); *Commonwealth Edison Co.*, 143 P.U.R.4th 463, 1993 WL 312271 at 10-12 (Order, June 2, 1993); *Northern Illinois Water Corp.*, 1982 WL 914957 at 5 (Order, Jan. 6, 1982) ("The Commission has approved the use of the Handy-Whitman Index to trend original cost dollars as a means of establishing valuation for rate-making purposes in numerous cases. Furthermore, the Index is widely recognized in the utility industry as a measure of the value of utility facilities.")

Cost to Abandon Regulator Stations	$175,713	378	0.39%	589	2.30
New Regulator Stations	$137,515	378	0.30%	589	1.77
New City Gate Stations	$0	379	0.00%	592	-
Total Construction Cost **	**$45,275,708**	[redacted]			
Weighted Index					**488.38**

* Restoration Cost Index is a weighted average of the Installation of PL Main and Installation of ST Main indices

** Total Construction Cost difference is due to rounding

H-W refers to Handy-Whitman Index®, North Central Region, Jan 1 2009

The Handy-Whitman Gas Construction Index is published twice each year: in May, including data for January of that year; and in November, including data for July of that year. Mr. Marano testified that the weighted index for the Baseline Year of 2011 should be determined when the Handy-Whitman Gas Construction Index for January 2011 is published using the method shown in his Exhibit SDM-4.2. Each subsequent year, the weighted index should be calculated when the Handy-Whitman Gas Construction Index for July of the previous year to escalate the baseline construction cost for changes in material and labor costs as follows

$$\text{For Year XXXX Adjusted Baseline Construction Cost} = \frac{\text{Weighted Index For July Year (XXXX -1)}}{\text{Weighted Index For January Year 2011}} \text{ X } \text{2011 Baseline Construction Cost}$$

The Rider ICR tariff requires that an information sheet be filed with the Commission by March 20 of each year specifying the ICR Charge Percentage to be effective for service rendered during the period April 1 through December 31 that year. Mr. Marano testified that because the January Handy-Whitman Gas Construction Index for a particular year is not published until May of that year, it would be too late for the requirements of the Rider ICR tariff. The July Handy-Whitman Gas Construction Index from the previous year, therefore, will be the most current information available to use each year for escalation of the Rider ICR baseline.

Mr. Marano further testified that PGL desired the annual baseline value in the Rider ICR tariff be rounded to the nearest ten-thousand (.01 million) dollars as it is currently reflected in the rider. The escalation factor would apply to the rounded amount and the result would likewise be rounded to the nearest ten-thousand dollars.

B. Staff's Response

Staff responded to PGL's Rider ICR Baseline proposal through the testimony of Dianna Hathhorn, Accountant, Accounting Department Financial Analysis Division.

Ms. Hathhorn agreed with Peoples Gas that there is no issue with respect to the potential cost recovery of operating and maintenance costs through Rider ICR.

With respect to Peoples Gas' proposed Rider ICR Baseline (or "QIP Baseline") of $45.28 million with an escalation factor based on the Handy-Whitman index in Mr. Marano's testimony, Ms. Hathhorn testified that she has no objections to PGL's proposals. Peoples Gas' proposed baseline and escalation factor methodology was shown in Attachment A of Ms. Hatthorn's testimony, which is a draft revised Rider ICR tariff provided in a data response.

Ms. Hathhorn further recommended two changes to Rider ICR's audit provisions due to the use of a baseline amount in calculation of Rider ICR charges. First, Ms. Hathhorn recommended adding language to test that the QIP Baseline is accurately applied to the charge under Rider ICR:

> Section I-Annual Internal Audit
> The Company shall submit to the Manager of the Accounting Department of the Commission's Financial Analysis Division, no later than September 1, an internal audit report that determines whether the ICR Charge and information provided in Section H have been calculated in accordance with this rider. The initial internal audit under this rider shall be submitted no later than September 1, 2012. All internal audits conducted under this rider shall include at least the following tests:
> … <u>and</u>
> <u>(5) A test to verify the QIP Baseline was calculated and applied correctly to the ICR Charge Percentage.</u>

Second, Ms. Hathhorn recommended language that the every five year independent audits include a requirement to review the number of miles completed during the audit period:

> Section J-Independent Audit
> The Company shall submit each five years to the Manager of the Accounting Department of the Commission's Financial Analysis Division and to the Commission an independent audit of the Company's infrastructure replacement plan, <u>which audit shall include a review of the number of miles of cast iron and ductile iron main replaced and the</u>

<u>infrastructure installed to support such replacement each year during the audit period.</u>

Ms. Hathhorn testified that Peoples Gas agreed to add language that incorporated her recommendations as shown in Attachment A of her testimony.

C. Response of Other Parties and Intervenors

None of the other parties submitted a response to Peoples Gas' Rider ICR Baseline proposal. In a legal brief, the AG expressly asserted that it was not waiving its right to challenge Rider ICR on appeal.

IV. Commission Analysis and Conclusion

The Commission finds, based on the record as a whole, that the initial Rider ICR Baseline of $45.28 million for the year 2011 with subsequent escalation factors based on the Handy-Whitman index as proposed by Peoples Gas will effectively exclude the recovery of legacy costs from PGL's 50 year plan through Rider ICR as the Commission had directed in its January 21, 2010 Order. The Commission also concludes that Rider ICR does not provide for the recovery of routine operating and maintenance expenses related to such legacy costs. Rider ICR shall thus be modified to incorporate the Rider ICR Baseline with escalation factor methodology proposed by Peoples Gas.

Furthermore, the Commission agrees with the inclusion of Staff's recommended changes to Rider ICR's audit provisions accepted by Peoples Gas. Accordingly, these recommendations shall be adopted in Rider ICR as shown in the draft revised tariff submitted with Staff's testimony in this proceeding.

V. Findings and Orderings Paragraphs

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

(1) Peoples Gas is an Illinois corporation engaged in the transportation, purchase, storage, distribution and sale of natural gas to the public in Illinois and is a public utility as defined in Section 3-105 of the Public Utilities Act;

(2) the Commission has jurisdiction over the parties and the subject matter herein;

(3) the recitals of fact and conclusions reached in the prefatory portion of this order are supported by the record and are hereby adopted as findings of fact;

(4) the Commission voted to grant rehearing, in part, on March 10, 2010;

(5) rehearing was granted solely on the issue of determining a Baseline for Rider ICR that would exclude the recovery of legacy costs forecasted for

Peoples Gas' 50 year plan and routine operating and maintenance expenses related to those forecasted costs;

(6) routine operating and maintenance expenses will not be recovered through Rider ICR;

(7) Peoples Gas shall adopt and implement a Baseline of $45.28 million for the year 2011 in Rider ICR;

(8) Peoples Gas shall adopt and implement an escalation factor methodology based on the Handy-Whitman Gas Construction Index to be applied to the Baseline in years subsequent to 2011 in Rider ICR, which methodology is described in the prefatory portion of this order;

(9) Peoples Gas shall adopt and implement the changes to Rider ICR's audit provisions proposed by Staff and accepted by Peoples Gas; and

(10) new tariff sheets authorized to be filed by this Order should be filed in accordance with Section 9-201(b) of the Public Utilities Act.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets currently in effect rendered by The Peoples Gas Light and Coke Company with respect to Rider ICR are hereby permanently canceled and annulled, effective at such time as the new tariff sheets approved herein become effective.

IT IS FURTHER ORDERED that The Peoples Gas Light and Coke Company is authorized to file new tariff sheets in accordance with Findings 7, 8, and 9 of this Order, applicable to service furnished on and after the effective date of said tariff sheets.

IT IS FURTHER ORDERED that any motions, petitions, objections, and other matters in this proceeding which remain unresolved are disposed of in a manner consistent with the conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this ___ day of ____________, 2010.

(SIGNED) MANUEL FLORES

Acting Chairman