

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 09-0436
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	and
	:	No. 09-0437
Petition Pursuant to Rider EEP of Schedule of Rates for	:	(Cons.)
Gas Service to Initiate a Proceeding to Determine the	:	
Accuracy of the Rider EEP Reconciliation Statement.	:	

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

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North Shore Gas Company (“North Shore”) and The Peoples Gas Light and Coke Company (“Peoples Gas”) (together, “the Utilities” or “NS-PGL”), in accordance with the schedule set by the Administrative Law Judge (“ALJ”) and Section 200.830 of the Rules of Practice of the Illinois Commerce Commission (the “Commission” or “ICC”), 83 Ill. Adm. Code § 200.830, submit this Brief on Exceptions, addressing the ALJ’s December 9, 2010 Proposed Order (the “Proposed Order”). The Utilities are also filing separately Exceptions to the Proposed Order (the “NS-PGL Exceptions”) that contains proposed revised Order language in black-lined format.

INTRODUCTION

The Proposed Order’s recommendations on most subjects are consistent with the evidence and the law, including its recommended rulings finding the Chicagoland Natural Gas Savings Program independent Governance Board’s decision to determine prudence at the portfolio level and the Board’s selection of a group of individual measures that comprised a prudent portfolio (even under the narrow Total Resource Cost or “TRC” test) to be prudent, its approval of the Utilities’ expenditures for tankless water heaters and high efficiency clothes

washers as prudent, and its adoption of an appropriate method for cost recovery disallowances in the event of an imprudence finding.

However, the Utilities submit Exceptions as to certain portions of the Proposed Order, specifically, the finding that policy decisions of the Board should be subject to full prudence review with no deference, and the finding that the inclusion of wall insulation in the Program was imprudent. The Utilities submit that the Proposed Order reflects a misunderstanding of certain of the Utilities' evidence, overlooks evidence that a properly recalculated "non-hindsight" "TRC" for this measure still would be above 1.0, relies on a Staff witness' opinion that substitutes the witness' judgment for that of the Board and that is contrary to actual experience, and, thus, that there is no legitimate question of imprudence; no imprudence finding is possible under the law and the facts.

ARGUMENT IN SUPPORT OF EXCEPTIONS

For ease of reference, the Utilities are using the section numbering of the Proposed Order and are only incorporating those sections to which they propose Exceptions.

III. CONTESTED ISSUES

A. Whether and to What Extent the Board's Program Decisions May Be Attributed to the Utilities for Cost Recovery Purposes

EXCEPTION NO. 1

The Proposed Order (pp. 4-6) concludes that the decisions and actions of the independent Governance Board are fully attributable to NS-PGL for the purpose of determining the prudence of the selection of energy efficiency measures for the Chicagoland Program. For the reasons appearing of record and discussed in the Utilities' Initial and Post-Hearing Reply Briefs, the Commission should find that Program and other policy decisions of the Board should not be

subject to a full prudence review, and that, in any event, the Utilities should not be subject to cost recovery disallowance for them.

The independent Governance Board, with expert advice, decided to adopt a portfolio of energy efficiency measures, decided that the essential prudence determination was the prudence of the portfolio, and adopted a prudent portfolio. It took into account benefits that are difficult to quantify, such as contributing to customer awareness of energy efficiency and market transformation, as well as quantitative benefits. The Board, with expert advice, decided to consider TRC test, along with the Program Administrator Cost (“PAC”) test, each of which calculates and compares certain (not all) of a measure’s incremental benefits to its incremental costs, as factors in deciding which measures to include in the portfolio. Beitel Reb., NS-PGL Ex. 4.0, 4:73 – 6:131.

The Utilities are not, as suggested by the Proposed Order (p. 6), using “expertise” as a shield to a full prudency review. Rather, what the Utilities are relying upon to justify a limited prudence review is the rare and unique combination of the experts hired by the Board, the special composition and structure of the Board, and the circumstance of the Commission’s approval of the Board (plus, the prudence of the Board’s decisions to determine prudence at the portfolio level and its selection of a group of individual measures that comprised a prudent portfolio (even under the narrow TRC test)). The Board is a short-term entity whose existence came about under special circumstances surrounding the 2007 Rate Case, described in brief by the Proposed Order. *See also* NS-PGL Initial Brief at pp. 8-12. Not only is the Board independent from the Utilities, but 3 out of 5 of its voting members are entities that are expected to represent customers, one of them being a major customer: the Illinois Attorney General’s Office, the Citizens Utility Board, and the City of Chicago. Moreover, the Illinois Commerce Commission

(the “Commission” or “ICC”) Staff (“Staff”) is a non-voting member. Staff has been a regular and active participant in Board meetings. Schott Reb., NS-PGL Ex. 3.0, 4:55-59. In the Commission’s own words, the Governance Board structure “should ensure independence from the Utilities and will likely result in representation of all or substantially all relevant interests.” *North Shore Gas Co., et al.*, ICC Docket Nos. 07-0241, 07-0242 (Cons.), pp. 183-184 (Order Feb. 5, 2008) (“2007 RC Order”). The Commission recognized that the manner in which the money would be spent would be far beyond the Utilities’ control. *Id.* Indeed, the Board, not the Utilities, established Program goals and performance criteria, oversaw the creation and issuance of requests for proposals, and selected the various experts who design and implement the Program, namely the independent Contract Administrator, and the independent Program Administrators. Michalkiewicz Dir., NS Ex. 1.0, 3:39-48; Michalkiewicz Dir., PGL Ex. 1.0, 3:39-48. The Board also formed an Operating Committee, with one representative for each voting member of the Board, to assist it in analyzing Rider EEP measures. Schott Reb., NS-PGL Ex. 3.0, 4:47-50.

The Proposed Order (p. 6) errs in concluding that it is fair to hold the Utilities accountable for effectuating choices they cannot control since they “voluntarily proposed ceding control”. The record in this case and past Commission Orders reflect the circumstances surrounding the role of other stakeholders in the proposal of the independent Governance Board and the Commission’s approval. *See* NS-PGL Initial Brief at pp. 8-12. The Utilities are not seeking to “trade away any legal responsibility”; rather, they ask only to be held accountable to the extent that they are responsible. The Utilities should be subject to prudence review for implementation issues and the Utilities role in them, such as did the Utilities administer the contracts properly and pay out the correct amounts for rebates. Schott, Tr. pp. 40-41; NS-PGL

Initial Brief at p. 17. There also could be prudence review for misappropriation of funds, including by the Board, but no one suggests that is the case in this Docket. Beitel, Tr. pp. 88-89; NS-PGL Initial Brief at p. 17.

Moreover, the Proposed Order (p. 5) is incorrect in its conclusion that the decision to rely on the performance of the Governance Board is not legally or functionally different from many decisions utilities make; indeed, it is vastly different. In contracts, partnerships, outsourcing and other business arrangements, the Utilities have contractual and other legal rights which hold parties accountable to the Utilities for the services they provide, or the products they sell. In the case of the Governance Board, no such accountability mechanism exists. In addition, the Utilities have the ability to direct, modify or reject the decisions and recommendations made by the experts and consultants they hire, including those situations where the behavior will be imputed to the Utilities and subject to prudence review by the Commission. In the case of the decisions of the Governance Board, the Utilities have only one of five equally weighed votes, and certainly no veto power. Thus, the unique facts of this case distinguish it from the myriad of instances in which a utility might simply rely on the advice or judgment of an outside expert.

Staff's Initial Brief (p. 6) raised the concept that the Utilities' position would create a "moral hazard" problem, but if Staff's reasoning were correct, then that reasoning would apply with even greater force as to the other four voting members of the Board. They would be presented with a situation in which they could direct the Utilities to make rebates to customers for both efficient and inefficient measures but the Utilities would not be allowed to recover the latter costs.

The Utilities have submitted two alternative forms of proposed language, Exception No. 1, Alternative A, and Alternative B, set forth in their Exceptions. Alternative A finds that

the Utilities should not be subject to cost recovery disallowances based on Board policy decisions. Alternative B finds grounds for substantial deference, which is consistent with Exception No. 2.

B. Deference To Decisions of the Program's Independent Governance Board

EXCEPTION NO. 2

The Proposed Order (pp. 6-7) erroneously gives no weight at all to the fact that the Program is determined by an independent Governance Board or to the role of other stakeholders in the proposal. The Commission established the governance structure of the Chicagoland Program to ensure prudence. There is substantial evidence that the Board received and considered extensive information and advice from its independent expert advisors in making Program policy decisions. *E.g.*, Beitel Reb., NS-PGL Ex. 4.0, 8:169 - 9:188; Plunkett Reb., NS-PGL Ex. 5.0, 1:4 - 4:88. The Program design team employed their experience and best judgment, conducted measure analysis, cost-effectiveness analysis, and developed benchmarks of other residential gas programs throughout the Midwest. Beitel Reb., NS-PGL Ex. 4.0, 9:189-194; *see also* Plunkett Sur., NS-PGL Ex. 7.0, 9:190-197. The Board, by unanimous vote, with the input of and consistent with the recommendations of its independent expert advisors, approved the overall portfolio of measures as a portfolio. Schott Reb., NS-PGL Ex. 3.0, 4:60-63; Beitel Reb., NS-PGL Ex. 4.0, 3:65 - 4:70, 4:82-87, 6:121-127, 13:278-295, 17:381 - 18:398, 19:417 - 21:480, 24:535-538, 26:576-580, 26:595 - 27:613.

The Utilities have submitted two alternative forms of proposed language, Exception No. 2, Alternative A, and Alternative B, set forth in their Exceptions. Alternative A reflects Exception No. 1, Alternative A. Alternative B is an independent Exception but also is consistent with Exception No. 1, Alternative B.

F.3. c. Wall Insulation

EXCEPTION NO. 3

The Proposed Order (pp. 16-19) errs in concluding that the independent Governance Board's decision to include wall insulation in the Chicagoland Program portfolio was unreasonable when made. For the reasons discussed in the Utilities' Initial and Post-Hearing Reply Briefs, and the reasons set forth below, the Commission should find that it was not imprudent to include wall insulation in the portfolio in the reconciliation period.

Even if the independent Governance Board's Program decisions were to be subject to prudence review and, in theory, could be a basis for denying the Utilities' cost recovery, wall insulation costs should be allowed because, as the evidence shows, as recognized to some degree in the Proposed Order (*e.g.*, Proposed Order, p. 20 (the Board could justifiably employ portfolio level measurement)), the prudence review should be performed only at the portfolio level. When launched, the portfolio had a TRC of 1.3 and PAC of 3.27. Beitel Reb., NS-PGL Ex. 4.0, 7:141-148. It is uncontested that the portfolio had an actual TRC test result of over 1.0.

The Proposed Order (p. 17) errs in its conclusion that "the erroneous wall insulation TRC ratio of 2.5 was derived from flawed and contradictory assumptions, and the Board's implementation actions suggest that those assumptions lacked credibility even to the Board." The Utilities have already admitted that one of the assumptions used to calculate the TRC was, in hindsight, not correct: the TRC for wall insulation originally was calculated by the Program to be 2.5, based on no incremental labor cost; *i.e.*, the assumption was that wall insulation would be entirely self-installed. Beitel Reb., NS-PGL Ex. 4.0, 23:527-530. The Contract Administrator testified that the actual Program experience demonstrated that two-thirds of wall insulation installations in Year 1 were performed by contractors, and one-third through self-installation,

resulting in an actual TRC, calculated in hindsight with this actual data, of 0.7. Beitel Sur., NS-PGL Ex. 6.0, 15:333-337. However, the fact that actual program experience differed from the forecast should not be grounds for disallowance.

Even if the Program's estimate that 100% of wall insulation would be self-installed was "flawed", it does not follow that a "reasonable" TRC would have been calculated at less than 1.0. The Proposed Order (p. 20) correctly recognizes that within the context of designing an energy efficiency portfolio, there would be a range of estimated per-measure outcomes that would be reasonable, but that such an exercise has not been undertaken in this proceeding. The Utilities' experts have stated that, even if a contractor-installed component had been factored into original cost estimates, the Board would not have been expected that the contractor-installed share would be greater than 1/3. Beitel Sur., NS-PGL Ex. 6.0; 16:338-344. Using this figure in a TRC analysis would have resulted in a TRC of 1.16. *Id.* at 16:345-348.

Furthermore, even if the Board knew in advance that the wall insulation was going to be two-thirds contractor install, and one-third self-install, leading to a measure-level TRC of 0.7 during the first six months of program operation, it was still reasonable to include wall insulation in the portfolio under the portfolio-level cost-effectiveness standard adopted by the Proposed Order. The Contract Administrator described the many energy and non-energy benefits associated with wall insulation, and furthermore that wall insulation is a common measure in cold-weather climate energy efficiency programs. Beitel Reb., NS-PGL Ex. 4.0, 25:559 - 26:591. Many of these benefits are not included in the TRC test. *E.g.*, Plunkett Reb., NS-PGL Ex. 5.0, 11:237-241. The Board considered wall insulation an essential part of the Program because it presents significant energy savings and comfort improvements, and reduces lost opportunities. *Id.* at 24:535-538. Wall insulation reduces convection, conduction, and radiant

heat loss. Beitel, Tr. at p. 65. The energy and comfort benefits associated with wall insulation are high because many homes in Chicago have no wall insulation (homes built in Chicago before 1970 have little to no insulation, and seventy-seven percent of homes in Chicago were built before 1970). Beitel Reb., NS-PGL Ex. 4.0, 5:559-562. Also, despite the initial wall insulation TRC less than 1.0 after only six months of program experience, the cost of wall insulation could be expected to come down, leading to higher TRC over time. Plunkett Sur., NS-PGL Ex. 7.0, 11:236-244. Finally, had Staff not objected to wall insulation leading to its removal from the portfolio, the Program Administrator could have shifted the marketing strategy to increase self-installation relative to contractor installation to bring the TRC over 1.0 with more time. Beitel Sur., NS-PGL Ex 6.0, 6:125-128. Given the energy and non-energy benefits of wall insulation, that the cost would likely come down over time, and that given more time the Program Administrator could have shifted marketing to increase the percentage of self-installation leading to a TRC over 1.0, it was not unreasonable to include wall insulation in the portfolio even with a TRC after only six months program experience of 0.7.

The Proposed Order (p. 20) acknowledges that measures below a TRC of 1.0 might be prudently included in a portfolio for sound reasons. There is ample evidence in the record supporting the inclusion of certain measures, including wall insulation, as part of a prudent energy efficiency plan. *E.g.*, Beitel Reb., NS-PGL Ex. 4.0, 3:65 – 4:70, 4:82-87, 6:121-127, 13:278-295, 17:381 – 18:398, 19:417 – 21:480, 24:535-538, 26:576-580, 26:595 – 27:613 (it is a very common practice for some individual measures to be included in an energy efficiency portfolio because they offer significant benefits not covered by the TRC (such as contributing to consumer awareness and increasing customer comfort in hot and cold weather, among many other examples) or will likely at some point become cost-effective); Plunkett Reb., NS-PGL Ex.

5.0, 19:412-429, 19:421 – 20:429 (Other energy efficiency programs have justifiably included measures with a TRC less than 1.0 – “lost-opportunity” measures - where the inclusion prevented a potential loss of savings from such measures over the long lifetimes of the inefficient measures. Wall insulation is a “lost-opportunity” measure).

By rejecting wall insulation as an imprudent measure in the portfolio, the Proposed Order contradicts its own finding (p. 11) that the Board’s use of the PAC test in designing the portfolio was not imprudent. The PAC for wall insulation was 3.92; only high efficiency boilers and ceiling insulation had higher PAC scores. Brightwell Reb., Staff Ex. 3.0, Attachment A. As described by Mr. Plunkett, the Board considered both the TRC and PAC cost-effectiveness tests to project and compare the benefits and costs of the energy efficiency measures and assess their value from the perspectives of the economy (society) and of customers. The Board also took into account benefits that are not captured by the two tests and benefits that occur over time and not just in the individual Program period. Plunkett Reb., NS-PGL Ex 5.0, 10:213 – 15:334.

There is no evidence in this case which supports the Proposed Order’s apparent misunderstanding (p. 17) that the Program assumed that “a meaningful percentage of small-volume customers would respond to [the economic distress of late 2008] by self-installing wall insulation”. Ms. Beitel testified that in most cases, residents install wall insulation when walls are already open as part of other remodeling or repair projects, and that the Program intended to increase the likelihood that customers would install insulation when the opportunities arose. Beitel Reb., NS-PGL Ex. 4.0, 25:566-569.

Many of the reasons cited in the Proposed Order to support its conclusion that the Board made flawed and contradictory assumptions with respect to wall insulation reflect the misunderstanding. It was not unreasonable for the Program designers to assume that some

customers would perform some remodeling or repair notwithstanding bad financial conditions. The opportunity to self-install wall insulation might arise in involuntary scenarios, such as when walls are open for necessary repairs (*e.g.*, water damage from ice dams, water seeps and foundation cracks), and in cases where customers have the financial resources to hire a contractor to perform remodeling, but with an appreciably tighter budget such that the opportunity to save money by self-installing wall insulation is attractive. Further, the Proposed Order (p. 18) errs in its suggestion that the Board acted in a contradictory fashion because it did “not assume that bad economic conditions would impede the selection of other efficiency measures that require contractor installation”. Those other measures, namely hot water heaters, clothes washers, and furnaces, are non-discretionary purchases by nature, unlike wall insulation. Customers generally must replace these items when they break to meet basic needs for heating, hot water, and clean clothes. Finally, the evidence does not support the Proposed Order’s conclusion (p. 18) that the installation of wall insulation is a “daunting” task. In fact, the evidence demonstrates that a full one-third of rebates paid in Program Year 1 was for wall installation that was self-installed, as noted above.¹ Moreover, there is substantial evidence that several retailers -- home improvement and hardware stores -- participated in the Program’s promotional efforts. Beitel Sur., NS-PGL Ex. 6.0; 15:321-323. By agreeing with Staff’s witness’ personal opinion that wall insulation installation is too difficult, the Proposed Order violates the prudence standard by substituting Staff’s witness’ judgment for that of the Board and its experts, as well as disregarding actual experience.

¹ The Proposed Order (p. 18) cites Staff’s Initial Brief at p. 17, which in turn cites Staff’s witness’ statement that, based on Internet searches, he concluded it was difficult and not something he would do. That testimony has little weight on its face, and is negated by the evidence that 1/3rd of the wall insulation installations was self-installation.

There is extensive evidence that it was reasonable for the Board to include wall insulation in the Chicagoland portfolio. At most, the conclusions in the Proposed Order present a reasonable difference of opinion, but cannot support an imprudence finding.

The Utilities have submitted proposed language, Exception No. 3, set forth in their Exceptions.

F.[G.] Disallowance Calculation

EXCEPTION NO. 3, CONTINUED

(If Exception No. 3 is adopted, then conforming changes to this subsection must be made)

The Proposed Order (pp. 19-21) correctly identifies a methodology for cost recovery disallowances, which it then applies to wall insulation expenditures by the Program. For the reasons discussed in Exception No. 3 above, wall insulation costs should not be disallowed.² Proposed language appears in the Exceptions.

IV. FINDINGS AND ORDERING PARAGRAPHS

EXCEPTION NO. 3, CONTINUED

(If Exception No. 3 is adopted, then conforming changes to this subsection must be made)

The Proposed Order (p. 21), in Findings and Orderings Paragraphs (7) through (10) and the first Ordering Paragraph, reflects its recommendation on wall insulation expenditures. For the reasons discussed in Exception No. 3 above, wall insulation costs should not be disallowed.

² The Proposed Order approves recovery by the Utilities commensurate with the benefit actually provided (70% of costs incurred), while disallowing recovery of remaining incremental costs. It notes that practically speaking, within the context of designing an energy efficiency portfolio, there would be a range of estimated per-measure outcomes that would be reasonable, but that it would be unproductive to prolong and complicate this proceeding by attempting to map out the boundaries of that range, given the relatively small amounts at issue. The Utilities agree to this methodology solely for purposes of this case, but reserve their rights in future proceedings involving this issue.

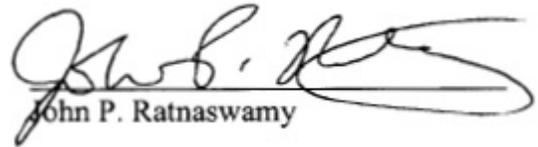
For the reasons discussed in Exception No. 3 above, wall insulation costs should not be disallowed. Proposed language appears in the Exceptions.

CONCLUSION

The proper application of the facts and law in this case dictates that the Proposed Order conclude that (1) the Board's Program decisions (decisions about what measures to include in the portfolio and other policy decisions) should not be a basis for imprudence findings against the Utilities and for disallowances of the Utilities' cost recovery; and (2) inclusion of wall insulation as a measure in the Chicagoland portfolio was not imprudent. The Proposed Order's proposed findings to the contrary would constitute reversible error.

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