

DIRECT TESTIMONY  
OF  
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Accounting Department  
Financial Analysis Division  
Illinois Commerce Commission

Application for Approval of a Reorganization pursuant to  
Section 7-204 of the Illinois Public Utilities Act

AGL Resources Inc., Nicor Inc., and  
Northern Illinois Gas Company d/b/a Nicor Gas Company

Docket No. 11-0046

April 28, 2011

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## ATTACHMENTS

- Attachment A- Joint Applicants' Responses to Staff Data Requests DLH-10.01  
and DLH-10.02
- Attachment B- Joint Applicants' Response to Staff Data Request DLH-1.07

1     **Witness and Schedule Identification**

2     Q.     Please state your name and business address.

3     A.     My name is Dianna Hathorn. My business address is 527 East Capitol Avenue,  
4           Springfield, Illinois 62701.

5  
6     Q.     By whom are you employed and in what capacity?

7     A.     I am currently employed as an Accountant in the Accounting Department of the  
8           Financial Analysis Division of the Illinois Commerce Commission (“Commission”  
9           or “ICC”).

10

11    Q.     Please describe your professional background and affiliations.

12    A.     I am a licensed Certified Public Accountant. I earned a B.S. in Accounting from  
13           Illinois State University in 1993. Prior to joining the Commission in 1998, I  
14           worked as an internal auditor for another Illinois state agency for approximately  
15           3.5 years. I also have 1.5 years experience in public accounting for a national  
16           firm.

17

18    Q.     Have you previously testified before any regulatory bodies?

19    A.     Yes. I have testified on several occasions before the Commission.

20

21    Q.     What is the purpose of your testimony in this proceeding?

22    A.     The purpose of my testimony is to present my analysis and recommendations on  
23           several issues presented by the application for authority to engage in a

24 reorganization and to enter into various agreements filed by AGL Resources Inc.,  
25 Nicor Inc., and Northern Illinois Gas Company d/b/a Nicor Gas Company (jointly,  
26 the “Joint Applicants” or individually, “AGL Resources,” “Nicor,” or “Nicor Gas”).  
27 Specifically, my testimony addresses (a) whether the proposed reorganization  
28 complies with the requirements set forth in paragraphs (2) and (3) of Section 7-  
29 204(b) of the Public Utilities Act (“Act”); (b) whether the Commission should  
30 approve certain affiliated interest agreements for which the Joint Applicants seek  
31 approval; and (c) whether the Commission should approve the proposed  
32 accounting entries associated with the reorganization.

33

34 Q. Have you included any attachments with your testimony?

35 A. Yes, I have included the following attachments, which present information  
36 prepared by the Joint Applicants:

37 Attachment A- Joint Applicants’ Responses to Staff Data Requests DLH-10.01  
38 and DLH-10.02

39 Attachment B- Joint Applicants’ Response to Staff Data Request DLH-1.07  
40

41 **Section 7-204(b)(2) – Subsidization of Non-Utility Activities and Section 7-**

42 **204(b)(3) – Allocation of Costs and Facilities**

43 Q. Sections 7-204(b)(2) and 7-204(b)(3) of the Act state as follows:

44 ... In reviewing any proposed reorganization, the Commission must find that: . . .  
45 (2) the proposed reorganization will not result in the unjustified subsidization of  
46 non-utility activities by the utility or its customers; (3) costs and facilities are fairly  
47 and reasonably allocated between utility and non-utility activities in such a  
48 manner that the Commission may identify those costs and facilities which are  
49 properly included by the utility for ratemaking purposes...

50

51 In your opinion, does the proposed reorganization comply with these

52 requirements?

53 A. No. The proposed reorganization cannot be found to comply with Sections 7-  
54 204(b)(2) and 7-204(b)(3) of the Act due to several issues I explain below with  
55 the proposed Operating Agreement (Joint Applicants Exhibit 6.1 or “OA”) and the  
56 AGL Services Agreement (Joint Applicants Exhibit 5.2, (“Services Agreement” or  
57 “SA”). However, if the Joint Applicants were to accept certain conditions  
58 discussed below, then I would recommend the Commission make the required  
59 findings with respect to these two subsections.

60

61 Q. Please briefly describe the difference between the OA and SA.

62 A. The OA is very similar to the affiliated interest agreement presently in place for  
63 transactions between Nicor Gas and its affiliates. It is a two-way transaction  
64 document, meaning Nicor Gas can both provide services to its affiliates, or  
65 receive services from its affiliates, by authority in the OA. In Nicor Gas’ last rate  
66 case, Docket No. 08-0363, the Commission ordered Nicor Gas to submit its OA  
67 for re-approval or a revised OA for approval. Nicor Gas chose the former and the  
68 OA is under review in Docket No. 09-0301. Those issues have been moved to  
69 this proceeding and will be considered in the OA phase of this case. I have  
70 several pending recommendations to the OA in Docket No. 09-0301. My  
71 testimony in the merger phase of this case addresses an OA issue brought about  
72 by the addition of parties to the OA proposed in the reorganization. The SA  
73 would govern transactions only from AGL Services Company (“AGSC”) to Nicor  
74 Gas, i.e., it is a one-way agreement.

75

76 **Operating Agreement**

77 **Recommendation #1: Require AGSC to Pay Nicor Gas Fully Distributed Cost**

78 Q. Please describe your recommendation to Section 5.1 (b)(i) of the OA to require  
79 AGSC to pay Nicor Gas fully distributed cost (“FDC”).

80 A. Presently, Section 5.1(b)(i) of the OA allows Nicor Gas to be paid by AGSC  
81 prevailing price, or if no such prevailing price exists, FDC. In other words, AGSC  
82 is allowed to pay Nicor Gas greater or less than Nicor Gas’ fully distributed costs  
83 if a prevailing price exists. If this occurs, then the difference between the  
84 prevailing price and Nicor Gas’ fully distributed cost is either a cost burden that  
85 would subsidize AGSC by Nicor Gas’ ratepayers, or vice versa.

86  
87 Q. Is it appropriate for AGSC to pay Nicor Gas above its FDC?

88 A. No, since AGSC is a services company. Services companies are typically used  
89 by multi-jurisdictional entities to provide services to multiple utilities at cost.  
90 While Nicor Gas could possibly benefit by charging AGSC in excess of its FDC,  
91 this would be inappropriate since AGSC would likely pass along this higher cost  
92 to another regulated utility. The SA proposed in this case, discussed later in my  
93 testimony, appropriately does not allow Nicor Gas to pay AGSC greater than  
94 FDC. It is appropriate for the OA to mirror this arrangement so that AGSC  
95 remains the pass through entity it is designed to be.<sup>1</sup>

96  
97 Q. Has the Commission required other Illinois utilities to be paid by their services

---

<sup>1</sup> See Joint Applicants Ex. 5.0, p. 6, lines 130-131, “The AGSC structure was also created to allow for AGSC to recover its costs but not to create either a gain or a loss in any accounting period.”

98 companies in the same manner you recommend?

99 A. Yes. In Docket No. 10-0408, in the affiliate interest agreement between The  
100 Peoples Gas Light and Coke Company, North Shore Gas Company, and their  
101 services company (“Peoples/North Shore AIA”), Section 2.1 (iv) requires  
102 transactions provided by the utilities to their services company, Integrys Support,  
103 to be priced at cost (NS-PGL Ex. 1.1, Docket No. 10-0408, Order, dated  
104 December 15, 2010). Consistent with the Peoples/North Shore AIA, I  
105 recommend transactions provided by Nicor Gas to AGSC be priced at cost.<sup>2</sup>  
106

107 Q. What is your recommended language change to Section 5.1(b) of the OA to  
108 address your Recommendation #1?

109 A. My recommended language is shown in legislative style as follows:

110 Section 5.1 ...

111 (b) Use of Facilities or Services.

112

113 (iii) Facilities or services provided by Nicor Gas  
114 to AGSC shall be charged by Nicor Gas to AGSC at fully  
115 distributed cost (determined as provided in Section 5.2) incurred by  
116 Nicor Gas in providing such facility or service to the AGSC.  
117

118 Q. Please summarize why the Commission should adopt Recommendation #1 as a  
119 condition of the reorganization.

120 A. The change under Recommendation #1 is necessary to the OA for the  
121 Commission to make the Section 7-204b(2) finding that the proposed  
122 reorganization will not result in the unjustified subsidization of non-utility activities

---

<sup>2</sup> The Joint Applicants already propose for transactions provided to Nicor Gas by AGSC be priced at cost. in Section IV of the AGL Services Agreement, Joint Applicants Ex. 5.2.

123 by the utility or its customers. As discussed above, the OA as proposed in the  
124 reorganization could result in the unjustified subsidization of non-utility activities  
125 by allowing AGSC to pay Nicor Gas more or less than Nicor Gas' fully distributed  
126 costs. Further, any costs that are not properly charged initially cannot be  
127 properly allocated between utility and non-utility activities, as required by Section  
128 7-204b(3).

129

130 **AGL Services Agreement**

131 **Recommendation #2: Add Access to Records Paragraph**

132 Q. Please describe your recommendation to add a paragraph to the SA regarding  
133 access to records.

134 A. The proposed SA does not contain any language regarding rights for access to  
135 records by parties or the ICC, as is contained in the proposed OA's Section 9.4.  
136 In discovery, the Joint Applicants have agreed to add the following language to  
137 the SA (Joint Applicants' Response to Staff Data Request DLH-4.10):

138 Access to Records. During the term of this Agreement and for a period  
139 of seven years after the expiration or termination of this Agreement by  
140 either AGSC or the Company (individually a "Party"), such Party shall  
141 have reasonable access to and the right to examine any and all books,  
142 documents, papers and records which pertain to services provided under  
143 this Agreement to such Party, and such Party shall provide access to, and  
144 the opportunity to examine, all such records which pertain to services  
145 provided under this Agreement by such Party. Each Party shall maintain  
146 all such records for a period of seven years after expiration or  
147 termination of this Agreement as to such Party. In addition, during the  
148 term of this Agreement and for a period of seven years after the  
149 expiration or termination of this Agreement, the ICC shall have access to  
150 the books and records of AGSC as they relate to transactions between  
151 AGSC and Nicor Gas to the extent allowed under Section 7-101 of the  
152 Illinois Public Utilities Act and subject to Section 5-108 of the Illinois  
153 Public Utilities Act.

154  
155 **Recommendation #3: Require Changes in Allocation Methods to be Filed with**

156 Commission

157 Q. Please describe your recommendation regarding changes in allocation methods  
158 used in the SA.

159 A. The SA, in the Description of Services section, states in part, "Substitution or  
160 changes may be made in the methods of allocation hereinafter specified, as may  
161 be appropriate and will be provided to state regulatory agencies and to each  
162 affected AGLR System Company." However, there is no requirement to provide  
163 these changes to the Commission. In discovery, the Joint Applicants have  
164 agreed to file on the ICC's e-Docket system in Docket No. 11-0046 with a copy to  
165 the Chief Clerk of the Commission, and provide a copy to the Manager of the  
166 Accounting Department, documentation of any substitution or changes in the  
167 methods of allocation in the Policies and Procedure Manual for the proposed  
168 AGL Services Agreement. (Joint Applicants' Response to Staff Data Request  
169 DLH-8.01) Therefore, I recommend adding the following language to the SA:

170 IV. COMPENSATION AND ALLOCATION. As and to the extent  
171 required by law, AGSC will provide such services at cost. The  
172 attached Exhibit I contains AGSC's Policies and Procedures  
173 Manual which describes the rules for determining and allocating  
174 costs for AGSC. Nicor Gas shall file on the ICC's e-Docket system  
175 in Docket No. 11-0046 with a copy to the Chief Clerk of the  
176 Commission, and provide a copy to the Manager of the Accounting  
177 Department, documentation of any substitution or changes in the  
178 methods of allocation in the Policies and Procedure Manual.  
179

180 Recommendation #4: Require Annual Internal Audit

181 Q. Please describe your recommendation regarding an annual internal audit of the  
182 SA.

183 A. The SA does not contain any requirement for an internal audit. The Joint  
184 Applicants stated that no internal audits of any AGL Services Agreements similar

185 to Joint Applicants Ex. 5.2 were performed between the years 2005 and 2010.

186 (Joint Applicants' Response to Staff Data Request DLH-4.03) The Joint  
187 Applicants further stated that, consistent with the requirements of 83 Ill. Adm.  
188 Code 550.150, the Joint Applicants would agree to conduct a biennial internal  
189 audit or have such audit conducted by independent public accountants and  
190 provide a copy of the audit report to the ICC's Manager of the Accounting  
191 Department. (Joint Applicants' Response to Staff Data Request DLH-4.12)

192

193 Q. Does the agreement to conduct biennial audits satisfy your concern that the SA  
194 be audited?

195 A. No. I recommend an annual, rather than a biennial audit be required. I also  
196 recommend that certain, specific tests be required within the audit. An annual  
197 audit is appropriate because the Services Agreement is new to Illinois, not  
198 regularly audited by AGLR, and there is potential for a large amount of costs to  
199 be charged to Nicor Gas through it. Further, the audit scope should be required  
200 to be focused on the certain, specific areas, where I believe there is the greatest  
201 potential for harm to ratepayers.

202

203 Q. Do any other affiliated interest agreements with Illinois utilities require annual  
204 internal audits?

205 A. Yes. The Master Regulated Affiliated Interest Agreement of The Peoples Gas  
206 Light and Coke Company and North Shore Gas Company ("Peoples/North Shore  
207 Master AIA"), includes a requirement in its Section 4.4 for an annual internal

208 audit testing transactions' compliance with the agreement. (Docket No. 07-0361,  
209 December 5, 2007) Section 4.3 of Peoples/North Shore's AIA also requires an  
210 annual internal audit. Ameren Illinois Company ("Ameren") conducts annual  
211 internal audits of its services company's request system, policies, procedures  
212 and controls, in accordance with the Commission's order in Docket No. 06-0070,  
213 November 21, 2006. MidAmerican Energy Company ("MidAmerican") is required  
214 to provide to Staff an annual internal audit of charges covered by its  
215 Intercompany Administrative Services Agreement ("IASA") (Section I. D. of Rider  
216 to IASA approved in Docket No. 06-0291, May 2, 2007).

217

218 Q. Why is it necessary to include specific audit tests in your recommendation for an  
219 annual internal audit?

220 A. The purpose of requiring specific tests is to ensure audit resources are engaged  
221 to monitor the risk areas that the Commission deems appropriate. The specific  
222 tests ensure the audit is a more useful product to Staff, intervenors and the  
223 Commission. Several tariffs adopted by the Commission have adopted audits  
224 with specific tests, including:

- 225 • Peoples/North Shore Rider Volume Balancing Adjustment Riders;
- 226 • Peoples Infrastructure Cost Recovery Rider;
- 227 • Commonwealth Edison Company Advanced Metering Program  
228 Adjustment;
- 229 • All uncollectibles expense riders adopted pursuant to Section 19-145 and  
230 16-111.8 of the Act;

- 231                   • All energy efficiency and demand response riders adopted pursuant to  
232                   Sections 8-103 and 8-104 of the Act; and
- 233                   • All purchased electricity riders adopted pursuant to Section 16-111.5 of  
234                   the Act.

235                   My recommended language changes to the SA regarding an annual internal  
236                   audit are included under Recommendation #6 below.

237

238                   Recommendation #5: Require Triennial Cost Study

239                   Q.     Please describe your recommendation regarding a cost study of the services  
240                   provided under the SA.

241                   A.     The SA's Policies and Procedures Manual states in several places that the  
242                   various allocation ratios it uses to allocate non-directly charged or assigned costs  
243                   will be updated at regular intervals, at least annually, using the most recent data  
244                   available. However, there is no requirement to conduct a full study of the cost of  
245                   services provided under the SA. A full study is necessary periodically to ensure  
246                   that AGSC is charging the system companies, i.e., Nicor Gas, appropriately, with  
247                   no over or under charging of its services. Therefore, I recommend a full study be  
248                   conducted every three years. The annual updates, which are already  
249                   established in the Manual, should be continued. My recommended language  
250                   changes to the SA regarding a requirement of a cost study are included under  
251                   Recommendation #6 below.

252

253                   Q.     Do any other affiliated interest agreements with Illinois utilities require triennial  
254                   cost studies?

255 A. Yes. Section 4.3 of Peoples/North Shore Master AIA and Section 4.4 of  
256 Peoples/North Shore AIA contain the identical requirement.

257

258 Recommendation #6: Require Annual Filing of Billing Report for SA

259 Q. Please describe your recommendation to include in the SA a requirement for the  
260 Joint Applicants to annually file a billing report.

261 A. I recommend that the Joint Applicants annually file by May 1 a billing report on  
262 the ICC's e-Docket system in Docket No. 11-0046 with a copy to the ICC's  
263 Accounting Department Manager and to the Office of the Chief Clerk of the ICC.  
264 The billing report should summarize the monthly charges to Nicor Gas from  
265 AGSC under the Services Agreement.

266

267 Q. Do any other affiliated interest agreements with Illinois utilities require  
268 compliance filings of monthly billing reports?

269 A. Yes. Section 4.5 of Peoples/North Shore Master AIA and Section 4.2 of  
270 Peoples/North Shore's AIA contain such requirements. Other utilities are  
271 required by the Commission to submit other compliance information related to  
272 their affiliated interest transactions. For example, Ameren submitted a quarterly  
273 list of challenges and responses regarding unreasonable charges under its  
274 affiliate agreement for transactions between the formerly separate Illinois utilities,  
275 pursuant to Docket No. 09-0233, January 6, 2010. MidAmerican submits a  
276 report of its quarterly true-up process of affiliate transactions (Section I.C. in  
277 Rider to IASA approved in Docket No. 06-0291).

278

279 Q. Please explain why the Commission should adopt Recommendation #6 as a  
280 condition of the reorganization.

281 A. The condition will provide the Commission with an important tool in monitoring  
282 affiliate transactions and assure that the reorganization does not result in the  
283 unjustified subsidization of non-utility activities by the utility or its customers and  
284 in determining that costs and facilities are fairly and reasonably allocated  
285 between utility and non-utility activities.

286

287 Q. Please provide your recommended language changes to the Services  
288 Agreement for your Recommendations 4, 5, and 6.

289 A. I recommend the following language be added to the Operating Agreement:

290 Annual Internal Audit, Annual Report, and Triennial Cost Study

291 a) Nicor Gas shall file an internal audit report annually with the ICC's  
292 Accounting Department Manager no later than July 1, that reflects the  
293 results of an internal audit which tests compliance with the terms of the  
294 Services Agreement, including, but not limited to the following:

295

296 1) Joint purchasing arrangements shall not increase Nicor Gas' fully  
297 distributed cost for goods or services;

298

299 2) All written sub-agreements for the provision of services shall have  
no terms inconsistent with the Services Agreement;

300

301 3) Every Party to the Services Agreement shall maintain adequate  
302 books and records with respect to the Services Agreement and that each  
303 party shall maintain sufficient internal controls to ensure that costs  
304 associated with transactions covered by this Services Agreement are  
305 properly and consistently allocated and billed in accordance with the terms  
and provisions of the Services Agreement;

306

307 4) The provision of services to Nicor Gas from AGSC are charged at a  
308 price in compliance with the most current Policies and Procedures Manual  
to the Services Agreement;

309

5) All costs charged to Nicor Gas are determined in accordance with

310 either a direct charge or a consistent, predetermined allocation  
311 methodology based upon current cost studies;

312 6) The fully distributed cost for provision of services are allocated  
313 based on cost and on a consistent predetermined allocation methodology  
314 that uses allocation factors set forth in the most current Policies and  
315 Procedures Manual to the Services Agreement. This item includes, but is  
316 not limited to, specific testing of the costs charged to Nicor Gas versus  
317 other AGLR affiliates for indirect costs; and

318 7) That allocation of costs among parties other than Nicor Gas does  
319 not directly or indirectly adversely impact Nicor Gas, such as by increasing  
320 Nicor Gas' costs.

321 The first such audit shall pertain to the period ending December 31, 2012,  
322 and shall be due on or before July 1, 2013.

323  
324 b) Nicor Gas shall file no later than May 1 annually a billing report on the  
325 ICC's e-Docket system in Docket No. 11-0046 with a copy to the ICC's  
326 Accounting Department Manager and to the Office of the Chief Clerk of  
327 the ICC. The billing report shall summarize the monthly charges to Nicor  
328 Gas from AGSC under the Service Agreement.

329  
330 c) At least once every three years, AGSC shall conduct a new study of the  
331 cost of services provided hereunder, for the purpose of testing compliance  
332 with the Agreement and to analyze the price of services provided. The  
333 study shall be updated at least annually. AGSC shall provide Nicor Gas  
334 with a copy of each new study or update, as the case may be, no later  
335 than May 1 of the year following the end of the most recently completed  
336 fiscal year covered by the new study or update. The first such new study  
337 shall pertain to the period ending December 31, 2012, and shall be due on  
338 or before May 1, 2013.  
339

340 Recommendation #7: Require Human Resources Indirect Costs Including Employee  
341 Benefits to be Directly Charged or Assigned

342 Q. Please describe your recommendation that employee benefits indirect costs in  
343 the SA be directly charged or assigned.

344 A. I recommend the Joint Applicants require AGSC to charge its employee benefits  
345 indirect costs through an overhead rate that can be charged to the affiliates  
346 based upon AGSC labor costs charged to the client companies. Presently,

347 AGSC charges employee benefits costs (i.e., health insurance costs, pension  
348 expense, etc.) and other indirect costs to affiliates by the use of ratios, such as  
349 the composite or number of end use customers. (See Attachment A)

350

351 Q. Why do you oppose the SA's proposed methodology?

352 A. While ratios may be reasonable for some indirect costs, such as those that are  
353 incurred on a shared basis which cannot easily be assigned by cost causation  
354 such as departmental overheads, the SA methodology would have Nicor Gas  
355 share in paying for the employee benefits costs directly incurred by AGL's  
356 affiliates in other jurisdictions. For example, if an AGSC employee charges 40  
357 hours of labor to Atlanta Gas Light Company ("Atlanta Gas"), the indirect costs of  
358 health insurance, pension, and payroll taxes associated with those 40 hours  
359 would not be charged only to Atlanta Gas. Instead, those charges would be  
360 pooled and charged to all affiliates based on the ratio of number of employees or  
361 the composite ratio. Under this methodology, Nicor Gas would inappropriately  
362 subsidize the other affiliates' costs of health insurance, pension, and payroll  
363 taxes associated with labor directly performed for Atlanta Gas.

364

365 Q. What is the magnitude of the costs that Nicor Gas could incur due to this  
366 methodology?

367 A. I am uncertain whether the costs would be allocated to Nicor Gas based on the  
368 composite allocator or ratio of number of employees. However, in the Joint  
369 Applicants' Response to Staff Data Request DLH-3.03, an illustrative example of

370 the composite ratio post-merger indicates Nicor Gas would receive approximately  
371 31% of the costs. Using number of employees, Nicor Gas' number of employees  
372 ratio is expected to be significant since AGL had 2,621 employees at February 1,  
373 2011 (2010 AGL annual report, p. 29) and Nicor Gas had approximately 2,200  
374 employees at year-end 2009 (2009 10-K).

375

376 Q. What is the Joint Applicants' rationale for this methodology?

377 A. The Joint Applicants stated that when AGL Resources was designing the current  
378 allocation methodology, a decision was made to simplify the steps in the overall  
379 allocation process. It further indicated that any change to this methodology would  
380 need to be made for all system companies or AGSC would no longer be able to  
381 claim an "at cost" allocation methodology. (See complete response in  
382 Attachment A)

383

384 Q. Do any other affiliated interest agreements with Illinois utilities allow indirect costs  
385 to be charged to affiliates in the manner proposed in the SA?

386 A. Not that I am aware of. Other Illinois utilities' affiliated interest agreements, some  
387 of which are listed below, require certain indirect costs such as employee  
388 benefits to be charged to affiliates based upon the amount of labor directly  
389 incurred by each affiliate.

390 • Ameren General Services Agreement<sup>3</sup>, Section 3, p. 5: "Overhead costs  
391 associated with labor, such as pensions and benefits, payroll taxes and injuries

---

<sup>3</sup> Docket No. 09-0234 (July 14, 2010), Ameren Services Company, service agreement between various

392 and damage expense will be charged to the Client Company based on Service  
393 Company labor costs charged to the Client Company.”

- 394 • Peoples/North Shore AIA Section 2.2 C: “An overhead shall be established and  
395 shall be applied to direct labor dollars (product of sub-paragraphs (i)(A) and  
396 (i)(B)) to include: 1. Costs associated with pensions, other post-employment  
397 benefits, social security taxes, unemployment compensation, health, dental and  
398 life insurance, training, vacation, sick, holiday and other employee benefits;...”
- 399 • Peoples/North Shore Master AIA, Section 2.2: “[...] to the extent possible and  
400 prior to allocating costs pursuant to subsections (ii) and (iii) of this Section 2.2,  
401 costs associated with a service that is specifically performed for a single Client  
402 Company will be directly assigned and billed to that Client Company;”
- 403 • Nicor Gas OA ((both existing and proposed) Section 5.2 c): “All direct labor  
404 charges apportioned to a Party (either apportioned directly or using an  
405 allocation methodology) shall be increased by a loading factor to reflect indirect  
406 labor-driven costs. [...] The labor loading shall include payroll taxes; medical,  
407 dental and vision insurance costs; pension and other postretirement health care  
408 benefits costs; incentive compensation plan costs; employee savings plans  
409 costs; training costs; other employee benefits; the employee benefits  
410 department costs; communications and computer support and facilities costs.”

411

412 Q. What is your recommended language to address this issue?

(..continued)

Ameren Companies including Central Illinois Public Service Company d/b/a AmerenCIPS, Central Illinois Light Company d/b/a AmerenCILCO, Illinois Power Company d/b/a Ameren IP

413 A. I recommend adding the following language (shown in double-underline prior to  
414 other proposed language from Recommendation #3 above) to the Services  
415 Agreement:

416 IV. COMPENSATION AND ALLOCATION. As and to the extent  
417 required by law, AGSC will provide such services at cost. The  
418 attached Exhibit I contains AGSC's Policies and Procedures  
419 Manual which describes the rules for determining and allocating  
420 costs for AGSC. AGSC shall include in the Policies and Procedures  
421 Manual detailed instructions mandating that indirect costs of human  
422 resources costs, including pension expense, health insurance, and  
423 payroll taxes, be charged to Nicor Gas by use of an overhead rate.  
424 Nicor Gas shall file on the ICC's e-Docket system in Docket No. 11-  
425 0046 with a copy to the Chief Clerk of the Commission, and provide  
426 a copy to the Manager of the Accounting Department,  
427 documentation of any substitution or changes in the methods of  
428 allocation in the Policies and Procedure Manual.  
429

430 Q. Please summarize why the Commission should adopt Recommendation #7 as a  
431 condition of the reorganization.

432 A. The change is necessary to the SA for the Commission to make the Section 7-  
433 204b(2) finding that the proposed reorganization will not result in the unjustified  
434 subsidization of non-utility activities by the utility or its customers . As discussed  
435 above, the SA as proposed in the reorganization could result in the unjustified  
436 subsidization of non-utility activities by requiring Nicor Gas to pay employee  
437 benefits costs unrelated to its regulated operations. Further, any costs that are  
438 not properly charged initially cannot be properly allocated between utility and  
439 non-utility activities, as required by Section 7-204b(3).

440

441 **Tax Allocation Agreement**

442 Q. Please describe the Joint Applicants' request for approval of a Tax Allocation  
443 Agreement.

444 A. In response to Staff Data Request DLH-1.07, the Joint Applicants stated that  
445 following approval of the application, the Tax Allocation Agreement Among  
446 Members of the AGL Resources Inc. Affiliated Group ("TAA") would be amended  
447 to include the surviving Nicor companies as parties to that agreement, and  
448 therefore requested approval of the TAA. (Attachment B) The Joint Applicants  
449 confirmed that they seek only to establish the TAA in this proceeding and any  
450 associated ratemaking treatment would be established in the next rate-making  
451 proceeding. (Joint Applicants' Response to Staff Data Request DLH-4.07)

452

453 Recommendation #8: Approve TAA and File Executed Copy on e-Docket

454 Q. What is your recommendation concerning the TAA?

455 A. I recommend the Commission approve the TAA. I also recommend the language  
456 in the Order state:

457 The Joint Applicants shall file the executed Tax Allocation  
458 Agreement on the ICC's e-Docket system in Docket No. 11-0046  
459 with a copy to the ICC's Accounting Department Manager and to  
460 the Office of the Chief Clerk of the ICC within thirty (30) days of the  
461 execution date. The Joint Applicants shall submit a status report  
462 to the ICC on e-Docket in Docket No. 11-0046 with a copy to the  
463 Manager of Accounting within six months of the order date of this  
464 proceeding approving the Tax Allocation Agreement and every six  
465 months thereafter until the final Tax Allocation Agreement has  
466 been executed.

467 The Joint Applicants have agreed to these recommendations in response to Staff  
468 Data Request DLH-4.08.

469

470 **Approval of Proposed Accounting Entries**

471 Q. At the date of their initial filing, the Joint Applicants stated they do not anticipate  
472 any accounting entries needing to be recorded; however, the analysis was not  
473 complete. (Joint Applicants Ex. 5.0, p. 12) Have the Joint Applicants provided  
474 additional information regarding the timing of the final analysis for the need for  
475 accounting entries?

476 A. Yes. The Joint Applicants stated that the analysis cannot be completed until the  
477 specific facts and circumstances are known at the time of filing the first financial  
478 statements for Nicor Gas with the Securities and Exchange Commission ("SEC")  
479 after the merger is completed. Further, Joint Applicants will have to wait until the  
480 SEC reviews the financial statements (for which there is no specific timetable)  
481 until they can be certain that the SEC ultimately agrees with its conclusions.  
482 (Joint Applicants' Response to Staff Data Request RP-2.05)

483

484 **Recommendation #9: File Final Disposition of Journal Entries on e-Docket**

485 Q. Do you have any recommendations regarding the accounting entries associated  
486 with the proposed Reorganization?

487 A. Yes. I recommend the Joint Applicants notify the Commission after the SEC  
488 review occurs. I also recommend the language in the Order state:

489 The Joint Applicants shall file on the ICC's e-Docket system in  
490 Docket No. 11-0046 with a copy to the Chief Clerk of the  
491 Commission, and a copy to the Manager of the Accounting  
492 Department of the final disposition of the accounting entries. If the  
493 SEC determines any journal entries are required, the Joint  
494 Applicants shall file on the ICC's e-Docket system in Docket No.  
495 11-0046 with a copy to the Chief Clerk of the Commission, and  
496 provide a copy to the Manager of the Accounting Department,  
497 copies of the accounting entries to be recorded on the regulatory

498 books of Nicor Gas, including preliminary amounts to be recorded,  
499 within 6 months after closing the merger transaction, and further file  
500 the final entries and amounts no later than 12 months after closing.  
501

502 **Additional Comments**

503 Q. Do you have any additional comments?

504 A. Yes, I do. In the rebuttal testimony of the Joint Applicants, I recommend that the  
505 revised OA and SA reflecting all agreed upon language changes should be  
506 attached and submitted for the record.

507 **Summary**  
508

509 Q. Please summarize the conclusions and recommendations contained in your  
510 testimony.

511 A. I conclude:

- 512 1) The proposed reorganization cannot be found to comply with Sections 7-  
513 204(b)(2) “the proposed reorganization will not result in the unjustified  
514 subsidization of non-utility activities by the utility or its customers” and 7-  
515 204(b)(3) “costs and facilities are fairly and reasonably allocated between  
516 utility and non-utility activities in such manner that the Commission may  
517 identify those costs and facilities which are properly included by the utility for  
518 ratemaking purposes” of the Act, due to several issues with the proposed  
519 Operating Agreement and the AGL Services Agreement.  
520 However, if the Commission imposes the conditions listed below, then my  
521 concerns regarding the Joint Applicants compliance with Section 7-204(b)(2)  
522 and (b)(3) of the Act will be satisfied:  
523

- 524  
525
1. Amend the Operating Agreement to require AGSC to pay Nicor Gas fully distributed cost;
- 526  
527
2. Amend the Services Agreement to add an access to records paragraph;
- 528  
529
3. Amend the Services Agreement to require changes in allocation methods to be filed with Commission;
- 530
4. Require an annual Internal Audit of the Services Agreement;
- 531  
532
5. Require a triennial cost study of the services provided under the Services Agreement;
- 533
6. Require the annual filing of a billing report for Services Agreement;
- 534  
535
7. Require that human resources indirect costs be directly charged or assigned;
- 536  
537
8. Require that the Joint Applicants file an executed copy of the Tax Allocation Agreement on e-Docket;
- 538  
539
9. Require that the Joint Applicants file the final disposition of journal entries on e-Docket.
- 540

- 541
- 2) Subject to the imposition of the condition listed above, as well as imposition of
- 542 my recommendations in ICC Staff Exhibits 1.0 and 3.0, I have no further
- 543 objections to the Operating Agreement;
- 544
- 3) Subject to the conditions listed above, I recommend that the Commission
- 545 approve the Services Agreement;
- 546
- 4) Subject to the condition listed above, I recommend that the Commission
- 547 approve the Tax Allocation Agreement; and
- 548
- 5) Subject to the condition listed above, I recommend that the Commission
- 549 approve the accounting treatment of the reorganization.
- 550

551 **Conclusion**

552 Q. Does this question end your prepared direct testimony?

553 A. Yes.

**Joint Applicants**  
**Response to: Illinois Commerce Commission**  
**Ill.C.C. Docket No. 11-0046**  
**DLH Tenth Set of Data Requests**

DLH 10.01 Q. Referring to Joint Applicants' response to Staff Data Request DLH-7.04, is it correct that indirect costs such as departmental overheads, general and administrative costs including employee benefit costs, and taxes are charged to AGLR System Companies by use of ratios, such as the composite or number of end use customers? If not, fully explain how these indirect costs are charged to AGLR System Companies.

DLH 10.01 A. Indirect costs incurred by AGL Services Company, including departmental overheads, administrative and general costs, employee benefit costs and taxes are charged to AGLR System Companies by use of ratios, such as the composite or number of end use customers as outlined in the Joint Applicants' response to DLH 7.04.

*Witness:* Elizabeth Reese

**Joint Applicants**  
**Response to: Illinois Commerce Commission**  
**Ill.C.C. Docket No. 11-0046**  
**DLH Tenth Set of Data Requests**

- DLH 10.02 Q. Referring to Joint Applicants' response to Staff Data Request DLH-10.01,
- a) Please provide the current overhead rate used for indirect costs by AGSC. Please provide all supporting calculations and workpapers. To the extent applicable, all documents and workpapers should be provided in Excel format with working formulas.
  - b) Please explain the rationale why indirect costs are not charged to AGLR System Companies proportionately with the associated labor generating such costs.
  - c) Please explain any reasons why indirect costs could not be charged as a loading factor as is current practice in Nicor Gas' Operating Agreement.
  - d) Please explain any other mitigating controls the Joint Applicants' may have to ensure Nicor Gas would not subsidize AGLR affiliates' indirect costs should the merger be approved.

- DLH 10.02 A.
- a) There is no overhead rate for indirect costs used by AGL Services Company (AGSC).
  - b) The current allocation process was designed under the requirements of the Public Utility Holding Company Act of 1935 (35 Act). This process was approved by the Securities and Exchange Commission (SEC) and has been either actively approved through approval of the agreement or passively through approval of rates in the various jurisdictions in which AGL Resources' utilities are rate regulated. Even though the 35 Act is no longer in effect, ASGC continues to operate in accordance with those guidelines. The intent of the overall allocation process is to fairly allocate costs of the service company among the system companies. Since AGSC uses the same methodology for all states, AGSC costs are not over allocated or under allocated as would be possible if we allocated using differing methodologies in the various states. When AGL Resources was designing the current allocation methodology under the 35 Act, a decision was made to simplify the steps used in the overall allocation process, which meant that all indirect costs, including those indirect costs that are directly related to people costs, would be allocated using ratios such as composite or end use customers.

- c) As noted in the response to b) above, the intent of the services agreement is to allocate the cost of AGSC fairly among the system companies. While many methodologies exist to allocate costs, AGL Resources designed a method to allocate costs principally on a cost causation basis and then to allocate systematically all remaining costs. People related indirect costs (such as employee benefits and payroll taxes) could be charged as a loading factor under the Services Agreement as is current practice in Nicor Gas' Operating Agreement with the appropriate processes and changes made to the systems used to calculate allocations. However, if this change is only made for Nicor Gas, then it would be possible that AGSC could over or under allocate its costs based on differing allocation methodologies. As a result, either the modification would need to be made for all system companies or AGSC would not longer be able to claim an "at cost" allocation methodology.
- d) As explained above, the structure of the AGL Services Company and the allocation process were established under the 35 Act. That act required an allocation methodology that prevents the possibility of cross-subsidization among system companies. AGL Resources maintains that practice and commits to maintaining an "at cost" services organization that allocates no more and no less than its actual cost to operate. Further, as detailed in the response to DLH 4.04, AGL Resources commits to ensuring cost causation charges and allocations where possible and a reasonable allocation method for all remaining costs.

*Witness:* Elizabeth Reese

**Joint Applicants**  
**Response to: Illinois Commerce Commission**  
**Ill.C.C. Docket No. 11-0046**  
**DLH First Set of Data Requests**

DLH 1.07 Q. Referring to Joint Applicants Ex. 6.0, p. 13, lines 263-264, provide a copy of each existing affiliated interest agreement that the Joint Applicants request Commission approval of as part of this proceeding.

DLH 1.07 A. In addition to the Proposed Operating Agreement (Joint Applicants Ex. 6.1) and the AGL Services Agreement (Joint Applicants Ex. 5.2), the Companies request approval of the following agreements which were included with the Joint Application as Attachment A and provided pursuant to Section 7-204A(a)(5):

Sequent Energy Management LLC: Gas Exchange  
Sequent Energy Management LLC: Interstate Hub Service Agreement  
Sequent Energy Management LLC: Intrastate Hub Service Agreement  
Sequent Energy Management LLC: Base Contract for Sale and Purchase of Natural Gas ("NAESB")

Following approval of the application, the attached DLH 1.07 Exhibit 1, Tax Allocation Agreement Among Members of the AGL Resources Inc. Affiliated Group, would be amended to include the surviving Nicor companies as parties to that agreement. The addition of these parties to the agreement is the only change contemplated at this time. Consequently, the Joint Applicants also request approval of the agreement as provided in DLH 1.07 Exhibit 1.

*Witness:* Gerald P. O'Connor

**TAX ALLOCATION AGREEMENT AMONG MEMBERS OF THE  
AGL RESOURCES INC. AFFILIATED GROUP**

WHEREAS, AGL Resources Inc., a corporation organized under the laws of the State of Georgia ("AGL Resources") and a registered holding company under the Public Utility Holding Company Act of 1935 ("Act"), together with its subsidiary companies, direct and indirect, listed in Appendix A, comprise the members of the AGL Resources consolidated group which will join annually in the filing of a consolidated Federal income tax return, and it is now the intention of AGL Resources and its subsidiaries, direct and indirect, (hereinafter collectively referred to as the "Group"), to enter into an agreement for the allocation of federal income taxes;

WHEREAS, certain members of the Group will join annually in the filing of certain consolidated state income tax returns (to the extent permitted or required under applicable state income tax laws), and it is now the intention of the Group to enter into an agreement for the allocation of state income taxes;

WHEREAS, by order dated December 23, 2003, the Securities and Exchange Commission has authorized AGL Resources and its subsidiaries to enter into this agreement which documents the process by which the Group has been allocating tax since October 5, 2000 and to continue to allocate consolidated income taxes in the manner herein provided; and

NOW, THEREFORE, each member ("Member") of the Group does hereby covenant and agree with one another that the current consolidated income tax liabilities of the Group shall be allocated as follows:

**ARTICLE I.**

**Definitions and Interpretation**

**Section 1.1 Definitions.**

For all purposes of this Agreement, except as otherwise expressly provided, the following terms shall have the following respective meanings:

"Acquisition Indebtedness" means indebtedness incurred by AGL Resources to finance the acquisition (including related costs) by AGL Resources of all of the issued and outstanding stock of Virginia Natural Gas, Inc. ("VNG") and any renewals or extensions thereof. Acquisition Indebtedness also includes indebtedness incurred by AGL Resources for the purpose of refinancing the indebtedness relating to the acquisition (including related costs) of all of the issued and outstanding stock of VNG.

"Code" means the Internal Revenue Code of 1986, as amended.

"Consolidated Group" means AGL Resources and all of its subsidiaries which, from time to time, may be included in any (i) federal income tax return filed by AGL Resources in accordance with sections 1501 and 1502 of the Code or (ii) Other Return.

"Consolidated Return" means any consolidated federal income tax return or Other Return filed by AGL Resources whether before or after the date hereof, which includes one or more Members of the Group in a consolidated, combined or unitary group of which AGL Resources is the common parent.

"Consolidated Return Year" means any period during which AGL Resources files a consolidated federal income tax return or Other Return that includes one or more Members of the Group in a consolidated, combined or unitary group of which AGL Resources is a common parent.

"Consolidated Taxable Income" is the taxable income of the Group as computed for federal or state income tax purposes.

"Consolidated Tax Liability" means, with reference to any taxable period, the consolidated, combined or unitary tax liability (including any interest, additions to tax and penalties) of the Consolidated Group for such taxable period (including the consolidated federal income tax liability and other consolidated, combined or unitary liability for Other Taxes).

"Corporate Taxable Income" means the income or loss of an associate company for a tax year computed as though such company had filed a separate return on the same basis as used in the Consolidated Return, except that dividend income from associate companies shall be disregarded, and other intercompany transactions eliminated in the Consolidated Return shall be given appropriate effect.

"Designated Official" means the Vice President, Treasurer of AGL Resources or such other official assigned the responsibilities of Vice President, Treasurer of AGL Resources.

"Other Return" means any consolidated, combined or unitary return of Other Taxes filed by AGL Resources or another Member of the Group, whether before or after the date hereof, which covers the operations of one or more Members of the Group.

"Other Taxes" means any taxes (including any interest and penalties) payable by AGL Resources or another Member of the Group to the government of any state, municipal or other political subdivision, including all agencies and instrumentalities of such government.

"Person" means any individual, partnership, firm, corporation, limited liability company, joint stock company, unincorporated association, joint venture, trust or other entity or enterprise, or any government or political subdivision or agency, department or instrumentality thereof.

"Regulations" means the Treasury Regulations, as amended, promulgated under the Code.

"Separate Return Tax" means the tax on the Corporate Taxable Income of a corporation which is a Member computed for purposes of this Agreement as though such company were not a Member of a consolidated group.

#### Section 1.2 References, Etc.

The words "hereof", "herein" and "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular

provision of this Agreement. All terms defined herein in the singular shall have the same meanings in the plural and vice versa. All References herein to any Person includes such Person's successors and assigns. All references herein to Articles and Sections shall, unless the context requires a different construction, be deemed to be references to the Articles and Sections of this Agreement. In this Agreement, unless a clear contrary intention appears the word "including" (and with correlative meaning "include") means "including but not limited to".

## ARTICLE II.

### Preparation and Filing of Tax Returns; Allocation of Taxes

#### Section 2.1 Federal Returns.

(a) A U.S. consolidated federal income tax return shall be prepared and filed by AGL Resources for each taxable year in respect of which this Agreement is in effect and for which the Consolidated Group is required or permitted to file a consolidated federal income tax return. AGL Resources and all its subsidiaries shall execute and file such consents, elections and other documents that may be required or appropriate for the proper filing of such returns.

(b) (i) The Consolidated Group will elect, on a timely basis, in accordance with Code Section 1552(b) and Section 1.1552-1(c)(2) of the Regulations to allocate its consolidated tax liability (other than alternative minimum tax ("AMT") and its related credits) among its Members under the method described in Sections 1.1502-33(d)(3) and 1.1552-1(a)(2) commencing with the consolidated taxable year ended September 30, 2001. The fixed percentage to be used for purposes of Regulations Section 1.1502-33(d)(3)(i) is 100%. The general effect of such method is to first allocate the consolidated tax liability among the Members of the Consolidated Group on the basis of the percentage of the total consolidated tax which the tax of such Member (other than AMT and its related credits) if computed on a separate return basis would bear to the total amount of the taxes (other than AMT and its related credits) for all Members of the Consolidated Group so computed. Then such method allocates an additional amount (the "Tax Benefit Amount") to each Member up to, but not greater than, the excess, if any, of its Separate Return Tax liability (other than AMT and its related credits) over the amount allocated to such Member in the previous sentence. The total of the Tax Benefit Amounts allocated to Members shall result in payments to, and an increase in the earnings and profits of, the Members who had items of deduction, loss or credits to which such Tax Benefit Amount is attributable. This election is intended to comply with Rule 45(c)(5) under the Act, as modified by Section 2(d) below.

(ii) The allocation of the AMT liability incurred by the Group and the resulting minimum tax credit shall be allocated in the manner set forth in Proposed and Temporary Treasury Regulation Sections 1.1502-55. This method generally allocates (i) any AMT paid by the Group based on the relative separate adjusted AMT of each Member and (ii) the alternative minimum tax credit ("AMTC") on the basis of the AMT previously assigned to such Member and assuming that AMTC is utilized on a "first in/first out" methodology, and that to the extent that AMTC arising in one year is not fully utilized, such AMTC is utilized proportionately by the Members previously assigned AMT for that year.

(c) Each Member's allocable share of the consolidated income tax liability as determined in Section 2.1(b) hereby shall be used in both (i) the determination of each Member's earnings and profits and (ii) determining the amounts to be paid (as provided in Section 3.4 of this Agreement) by Members to AGL Resources with respect to each Member's share of the Consolidated Group's Tax liability and payments from AGL Resources to Members with respect to the use of a Member's tax attributes.

(d) (i) The aggregate of all amounts paid by Members of the Consolidated Group (the "Paying Members") as a result of the excess of each Members' Separate Return Tax liability (as determined under Section 1.1552-1(a)(2)(ii) of the Regulations) over the amount allocated to such Member as its share of the Consolidated Tax Liability under Code Section 1552 (i.e., the Tax Benefit Amount) shall be paid by AGL Resources to the other Members (the "Loss Members") which had tax deductions, losses and credits to which such payments by the Paying Members are attributable. The apportionment of such payments among Loss Members shall be in a manner that reflects the Consolidated Group's absorption of such tax attributes in the manner described in Section 2.1(e) below. The payments to the Loss Members for their tax attributes shall be pursuant to a consistent method which reasonably reflects such items of loss or credit (such consistency and reasonableness to be determined by the Designated Official).

(ii) Notwithstanding the provisions of section 2.1(d)(i), the Tax Benefit Amount allocated to AGL Resources and paid to AGL Resources as a result of its being a Loss Member shall be limited to the tax benefit attributable to Acquisition Indebtedness. The portion of AGL Resources' tax benefits which are not attributable to Acquisition Indebtedness shall be reallocated to Paying Members of the Consolidated Group other than AGL Resources in accordance with the principles contained in section 2.1(b)(i). If AGL Resources should become a Paying Member of the Consolidated Group, AGL Resources would be allocated its proportional share of the consolidated tax liability and Tax Benefit Amount, up to the amount of its Separate Return Tax, in accordance with section 2.1.

(e) In apportioning the payments to Loss Members for the Tax Benefit Amount pursuant to Section 2.1(d) hereof:

(i) any consolidated net operating loss ("NOL") shall be allocated among the group Members pursuant to Regulations Section 1.1502-21(b). To the extent the consolidated NOL is carried back, any Member's individually allocable NOL shall be deemed carried back and utilized in proportion to the amount that the Member's NOL bears to the consolidated NOL. Analogous principles shall apply in the case of NOL carryforwards;

(ii) with respect to each type of credit used to offset all or a portion of the Consolidated Tax Liability otherwise payable, such credit shall be allocated among the Members by crediting to each Member an amount of credit which that Member would have available to utilize on a separate return basis in a manner consistent with the method set forth in Section 2.1(e)(i) above.

(iii) the cost of any credit recapture which results in the payment of tax shall be specifically allocated to the Member whose credit is recaptured determined in a manner consistent with the provisions of Section 2.1(e)(i) above.

(f) The allocation of tax shall be subject to further adjustment from time to time on account of the payment of additional tax or the receipt of a refund attributable to either the filing of an amended return or on account of the results of an audit conducted by the Internal Revenue Service or other relevant taxing authority.

#### Section 2.2 Other Taxes.

(a) AGL Resources will prepare and file (or cause to be prepared and filed) all returns of Other Taxes which are required to be filed with respect to the operations of AGL Resources and its subsidiaries. In the event any taxing authority requires or permits that a combined, consolidated or unitary return be filed for Other Taxes, which return includes both AGL Resources and a subsidiary, AGL Resources may elect to file such return and shall have the right to require any Member to be included in such return. AGL Resources will advise each of its subsidiaries included in each Other Return and each governmental office in which any Other Return is filed. Other Taxes shall be allocated among the Group in a manner that is consistent with the method set forth in Article 2 hereof. Furthermore, amounts due to or from AGL Resources with respect to Other Taxes, shall be determined in a manner consistent with Sections 2.1(b) and 2.1(d).

(b) Each Member of the Group that does not file an Other Return together with any other Member of the Group shall be solely responsible and obligated to pay the tax liability with respect to such return from its own funds. Such returns shall be prepared and filed by AGL Resources or the Member filing the Other Return.

(c) If any Member of the Group is required to file a combined, consolidated or unitary return for Other Taxes with another Member of the AGL Resources Group, but not with AGL Resources (an "Other Taxes Subgroup"), then AGL Resources shall have the rights, powers and obligations to file such tax returns and apportion among and, collect and remit from, the applicable Members such Other Taxes as the rights, powers and obligations given to AGL Resources under this Agreement with respect to the Consolidated Tax Liability. Such returns shall be prepared and filed by AGL Resources. If the right to file a combined, consolidated or unitary return for Other Taxes is optional, then AGL Resources shall decide which of its subsidiaries should, to the extent permitted by law, join in the filing of such return.

#### Section 2.3 Member Tax Information.

The Members of the Consolidated Group shall submit the tax information requested by the Designated Official of AGL Resources in the manner and by the date requested, in order to enable the Designated Official to calculate the amounts payable by the Members pursuant to Article 3 hereof.

### ARTICLE III.

#### Responsibility For Tax; Intercompany Payments

##### Section 3.1 Responsibility.

Assuming the Members of the Consolidated Group have fulfilled their obligations pursuant to this Article III, then AGL Resources will be solely responsible for, and will

indemnify and hold each Member of the Consolidated Group harmless with respect to, the payment of: (a) the Consolidated Tax Liability for each taxable period for which, as determined under Section 2.1 hereof, AGL Resources filed or should have filed a Consolidated Return; and (b) any and all Other Taxes due or payable with respect to any Other Return which is or should have been filed by AGL Resources.

**Section 3.2 Federal Tax Payments.**

(a) With respect to each Consolidated Return Year, the Designated Official shall estimate and assess or pay to Members of the Consolidated Group their share of estimated tax payments to be made on a projected consolidated federal income tax return for each year. In making this determination, AGL Resources shall elect a method for determining estimated tax and each Member shall follow that method. Such Members will pay, to AGL Resources or be paid by AGL Resources, such estimates not later than the 15th day of the 4th, 6th, 9th and 12th months of such Consolidated Return Year. With respect to any extension payment, the Designated Official shall estimate and assess or pay to Members of the Consolidated Group their share of such extension payment. The difference between (1) a Member's estimated tax payments used for computation of the quarterly estimated payments plus their extension payments and (2) such Member's actual Tax Liability for any Consolidated Return Year as determined under Section 2.1(b) hereof, shall be paid to AGL Resources or by AGL Resources within sixty (60) days after the filing of the consolidated federal income tax return.

(b) AGL Resources shall have sole authority, to the exclusion of all other Members of the Consolidated Group, to agree to any adjustment proposed by the Internal Revenue Service or any other taxing authority with respect to items of income, deductions or credits, as well as interest or penalties, attributable to any Member of the Consolidated Group during any Consolidated Return Year in which such Member was a Member of the Consolidated Group notwithstanding that such adjustment may increase the amounts payable by Members of the Consolidated Group under this Section 3.2 or Section 3.3 hereof. In the event of any adjustment to the Consolidated Tax Liability relating to items of income, deductions or credit, as well as interest or penalties, attributable to any Member of the Consolidated Group by reason of an amended return, claim for refund or audit by the Internal Revenue Service or any other taxing authority, the liability of all other Members of the Consolidated Group under paragraphs (a) of this Section 3.2 or Section 3.3 hereof shall be redetermined to give effect to such adjustment as if such adjustment had been made as a part of the original computation of such liability, and payment from a Member to AGL Resources or by AGL Resources to a Member, as the case may be, shall be promptly made after any payments are made to the Internal Revenue Service or any other taxing authority, refunds received or final determination of the matter in the case of contested proceedings. In such event, any payments between the parties shall bear interest at the then prevailing rate or rates on deficiencies assessed by the Internal Revenue Service or any other relevant taxing authority, during the period from the due date of the Consolidated Return (determined without regard to extensions of time for the filing thereof) for the Consolidated Return Year to which the adjustments were made to the date of payment.

### Section 3.3 Other Tax Payments.

Payments by a Member with respect to Other Taxes and required estimates thereof for which any other Member has joint and several liability shall be calculated and made by or to such Member in the same manner as that provided in Section 3.2. The principles set forth in Section 3.2 governing the determination and adjustment of payments as well as the method of payment to or from such Member with respect to federal income taxes shall be equally applicable in determining and adjusting the amount of and due date of payments to be made to or from such subsidiary with respect to Other Taxes and estimates thereof. Each Member shall pay, directly to the appropriate taxing authority, all taxes for which such Member is liable and for which no other Member has joint or several liability.

### Section 3.4 Payment Mechanics.

(a) Any payments to be made by a subsidiary of AGL Resources pursuant to Section 2.1, 2.2, 3.2 or 3.3 hereof shall be made by such subsidiary to AGL Resources by either promptly crediting as an offset against amounts owed to such Member by AGL Resources or to the extent no amounts are owed to such Member by AGL Resources, by cash payments to AGL Resources. To the extent any payments are to be made to a subsidiary with respect to the use of such subsidiary's tax attributes by the Consolidated Group pursuant to Section 2.1, 2.2, 3.2 or 3.3 hereof, AGL Resources shall make such payment to such subsidiary by either promptly crediting as an offset against amounts owed by such Member to AGL Resources, or to the extent no amounts are owed to AGL Resources by such Member, by cash payments to the Member.

(b) Tax payments by AGL Resources with respect to any Consolidated Tax Liability shall be paid by AGL Resources and shall be debited to the Member of the Consolidated Group for their respective shares of such Consolidated Tax Liability as determined pursuant to Article II hereof. Tax refunds received by AGL Resources with respect to any Consolidated Tax Liability, shall be paid by AGL Resources to the Member of the Consolidated Group entitled to such tax refund, as determined under Article II.

(c) AGL Resources shall be responsible for maintaining the books and records with respect to the inter-company accounts reflecting the amounts owned, collected and paid with respect to taxes pursuant to this Agreement.

(d) AGL Resources may delegate to other Members of the Consolidated Group responsibilities for the collection and disbursement of monies as required under this Agreement as well as responsibilities for maintaining books and records as required under this Agreement.

### Section 3.5 Administration.

The provisions of this Agreement shall be administered by the Designated Official. The interpretations of this Agreement by the Designated Official shall be conclusive.

## ARTICLE IV.

### Miscellaneous Provisions

#### Section 4.1 Effect.

The provisions hereof shall fix the rights and obligations of the parties as to the matters covered hereby whether or not such are followed for federal income tax or other purposes by the Consolidated Group, including the computation of earnings and profits for federal income tax purposes.

#### Section 4.2 Effective Date and Termination of Affiliation.

This Agreement shall be effective with respect to all taxable years ending on or after October 5, 2000, in which any subsidiary of AGL Resources is a Member of the Consolidated Group for any portion of the tax year. In the event that a party to this Agreement ceases to be a Member of the Consolidated Group, the rights and obligations of such party and each other party to this Agreement shall survive, but only with respect to taxable years including or ending before the date such party ceases to be a Member of the Consolidated Group.

#### Section 4.3 Notices.

Any and all notices, requests or other communications hereunder shall be given in writing (a) if to AGL Resources to Attention: Vice President, Treasurer, AGL Resources Inc., Ten Peachtree Place, Atlanta, Georgia 30309, Facsimile Number: 404-584-3589 and (b) if to any other person, at such other address as shall be furnished by such person by like notice to the other parties.

#### Section 4.4 Expenses.

Each party hereto shall pay its own expenses incident to this Agreement and the transactions contemplated hereby, including all legal and accounting fees and disbursements.

#### Section 4.5 Benefit and Burden.

This Agreement shall inure to the benefit of, and shall be binding upon, the parties hereto and their respective successors.

#### Section 4.6 Amendments and Waiver.

No amendment, modification, change or cancellation of this Agreement shall be valid unless the same is in writing and signed by the parties hereto. No waiver of any provision of this Agreement shall be valid unless in writing and signed by the person against whom that waiver is sought to be enforced. The failure of any party at any time to insist upon strict performance of any condition, promise, agreement or understanding set forth herein shall not be construed as a waiver or relinquishment of the right to insist upon strict performance of the same or any other condition, promise, agreement or understanding at a future time.

**Section 4.7 Assignments.**

Neither this Agreement nor any right, interest or obligation hereunder may be assigned by any party hereto and any attempt to do so shall be null and void.

**Section 4.8 Severability.**

The invalidity or unenforceability of any particular provision of this Agreement shall not affect the other provisions hereof, and this Agreement shall be construed in all respects as if such invalid or unenforceable provision were omitted.

**Section 4.9 Entire Agreement.**

THIS AGREEMENT SETS FORTH ALL OF THE PROMISES, AGREEMENTS, CONDITIONS, UNDERSTANDINGS, WARRANTIES AND REPRESENTATIONS AMONG THE PARTIES WITH RESPECT TO THE TRANSACTIONS CONTEMPLATED HEREBY, AND SUPERSEDES ALL PRIOR AGREEMENTS, ARRANGEMENTS AND UNDERSTANDINGS BETWEEN THE PARTIES HERETO, WHETHER WRITTEN, ORAL OR OTHERWISE. THERE ARE NO PROMISES, AGREEMENTS, CONDITIONS, UNDERSTANDINGS, WARRANTIES OR REPRESENTATIONS, ORAL OR WRITTEN, EXPRESS OR IMPLIED, AMONG THE PARTIES EXCEPT AS SET FORTH HEREIN.

**Section 4.10 Applicable Law.**

THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF GEORGIA.

**Section 4.11 Counterparts.**

This Agreement may be executed in one or more counterparts, each of which shall constitute an original and together which shall constitute one instrument. The parties hereto specifically recognize that from time to time other corporations may become Members of the Consolidated Group and hereby agree that such new Members may become Members to this Agreement by executing a copy of this Agreement and it will be effective as if all the Members had re-signed.

**Section 4.12 Attorneys' Fees.**

If any Member or former Member hereto commences an action against another party to enforce any of the terms, covenants, conditions or provisions of this Agreement, or because of a default by a party under this Agreement, the prevailing party in any such action shall be entitled to recover its costs, expenses and losses, including attorneys' fees, incurred in connection with the prosecution or defense of such action from the losing party.

#### Section 4.13 No Third Party Rights.

Nothing in this Agreement shall be deemed to create any right in any creditor or other person or entity not a party hereto and this Agreement shall not be construed in any respect to be a contract in whole or in part for the benefit of any third party.

#### Section 4.14 Further Documents.

The parties agree to execute any and all documents, and to perform any and all other acts, reasonably necessary to accomplish the purposes of this Agreement.

#### Section 4.15 Headings and Captions.

The headings and captions contained in this Agreement are inserted and included solely for convenience and shall not be considered or given any effect in construing the provisions hereof if any question of intent should arise.

#### Section 4.16 Departing Members.

(a) In the event that any Member of the Group at any time leaves the Group and, under any applicable statutory provision or regulation, that Member is assigned and deemed to take with it all or a portion of any of the tax attributes of the Group (including but not limited to NOL, credit carry forwards, and AMTC carry forwards), then to the extent that the amount of tax attributes so assigned differs from the amount of such attributes previously allocated to such Member under this agreement, the departing Member shall appropriately settle with the Group. Such settlement shall consist of payment (1) on a dollar for dollar basis for all differences in credits, and, (2) in the case of NOL differences (or other differences related to other deductions), in a dollar amount computed by reference to the amount of NOL multiplied by the applicable tax rate relating to such NOL. The settlement payment shall be paid to AGL Resources within sixty days after the Member leaves the Group. The settlement amounts shall be allocated among the remaining Members of the Group in proportion to the relative level of attributes possessed by each Member and the attributes of each Member shall be adjusted accordingly.

(b) Upon the departure of any Member from the Group, such Member shall allocate its items of income, deduction, loss and credit between the period that it was a Member of the Group and the period thereafter based upon a closing of the books methodology allowed under Treasury Regulation Section 1.1502-76(b)(2). The difference between (1) its prior estimated taxes or payments of Tax Benefit and (2) the amount of taxes due or payments of Tax Benefit due to that Member, shall be appropriately settled on the day such Member leaves the Group or on an alternative date mutually agreeable in writing to the Group and the departing Member.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed, each in its name and on its behalf by one of its officers duly authorized.

Date: Jan. 13<sup>th</sup> 2004

**AGL Resources Inc.  
AGL Energy Corporation  
AGL Propane Services, Inc.**

By: Richard T. O'Brien  
Richard T. O'Brien  
Executive Vice President and Chief Financial Officer

**Atlanta Gas Light Company  
Atlanta Gas Light Services, Inc.  
AGL Interstate Pipeline Company  
Virginia Natural Gas, Inc.  
Chattanooga Gas Company  
Customer Care Services, Inc.  
AGL Investments, Inc.  
AGL Macon Holdings, Inc.  
AGL Networks, LLC  
AGL Peaking Services, Inc.  
AGL Rome Holdings, Inc.  
AGL Services Company  
Georgia Energy Company  
Georgia Gas Company  
Georgia Natural Gas Company  
Pinnacle LNG, Inc.  
Pivotal Energy Services, Inc.  
Pivotal Propane of Virginia, Inc.  
Sequent Energy Management, LP  
Sequent, LLC  
Sequent Holdings, LLC  
Sequent Energy Marketing, LP  
Southeastern LNG, Inc.  
TES, Inc.  
Trustees Investments, Inc.**

Date: Jan 13<sup>th</sup> 2004

By: Andrew W. Evans  
Andrew W. Evans, Vice President & Treasurer

Date: Jan 13, 2004

**Global Energy Resources Insurance Corporation  
Energy Risk Insurance Services Company  
AGL Capital Corporation**  
By: Paul R. Shlanta  
Paul R. Shlanta, President

Appendix A

**Members of the AGL Resources Consolidated Group**

<u>Name of Company</u>	<u>Incorporation</u>
AGL Capital Corporation	Nevada
AGL Consumer Services, Inc. (A)	Georgia
AGL Energy Corporation	Delaware
AGL Energy Services, Inc. (B)	Georgia
AGL Energy Wise Services, Inc. (A)	Georgia
AGL Gas Marketing, Inc. (C)	Georgia
AGL Interstate Pipeline Company (D)	Georgia
AGL Investments, Inc.	Georgia
AGL Macon Holdings, Inc. (D)	Georgia
AGL Networks, LLC	Delaware
AGL Peaking Services, Inc. (D)	Georgia
AGL Power Services, Inc. (C)	Georgia
AGL Propane Services, Inc.	Delaware
AGL Propane, Inc. (E)	Georgia
AGL Resources Inc.	Georgia
AGL Rome Holdings, Inc.	Georgia
AGL Services Company	Georgia
Atlanta Gas Light Company	Georgia
Atlanta Gas Light Services, Inc. (F)	Georgia
Chattanooga Gas Company	Tennessee
Customer Care Services, Inc.	Georgia
Energy Risk Insurance Services Corporation (M)	British Virgin Islands

Georgia Energy Company (G)	Georgia
Georgia Engine Sales and Service Co. (C)	Georgia
Georgia Gas Company (D)	Georgia
Georgia Natural Gas Company	Georgia
Georgia Natural Gas Services, Inc. (F)	Georgia
Global Energy Resources Insurance Corporation	British Virgin Islands
Network Energies, Inc. (H)	Nevada
Network Energies, LP (H)	Georgia
Peachtree Pipeline Company (I)	Georgia
Pinnacle LNG, Inc. (F)	Georgia
Pivotal Energy Services, Inc. (D)	Georgia
Pivotal Propane of Virginia, Inc. (N)	Virginia
Retired Main, LLC (H)	Delaware
Sequent, LLC	Georgia
Sequent Energy Management, LP	Georgia
Sequent Energy Marketing, LP (D)	Georgia
Sequent Holdings, LLC	Georgia
Southeastern LNG, Inc.	Georgia
TES, Inc. (F)	Georgia
Trustees Investments, Inc.	Georgia
Utilipro Canada Corporation (J)	Canada
Utilipro Inc. (K)	Georgia
Utilipro International, Inc. (L)	Canada
Virginia Natural Gas, Inc.	Virginia

Footnotes:

- (A) Dissolved December 17, 2002
- (B) Converted to a Georgia limited liability company (AGL Energy Services, LLC) on January 29, 2001, and name officially changed to Sequent, LLC on April 9, 2001

- (C) Dissolved September 14, 2001
- (D) Inactive as of December 31, 2002
- (E) Combined with the propane operations of Atmos Energy Corporation, Piedmont Natural Gas Company and TECO Energy, Inc. on August 10, 2000 to form US Propane
- (F) Incorporated but not organized as of December 31, 2002
- (G) Subsidiary written-off during 2002
- (H) Dissolved December 20, 2002
- (I) Incorporated but not organized, dissolved May 16, 2002
- (J) Dissolved August 22, 2002
- (K) Portion of assets sold as of February 28, 2001 and remaining assets combined with Customer Care Services, Inc. as of March 5, 2001
- (L) Dissolved September 3, 2002
- (M) Incorporated as of May 20, 2003 to carry on general insurance business or activities as an adjuster
- (N) Formed on September 26, 2003 to construct and operate a propane air facility pending approval by the Virginia State Corporation Commission.