Public

Direct Testimony

of

Rochelle Phipps
Finance Department
Illinois Commerce Commission

AGL Resources Inc., Nicor, Inc. and
Northern Illinois Gas Company d/b/a Nicor Gas
Joint Application for Approval of a Reorganization
Pursuant to Section 7-204 of the Public Utilities Act

Docket No. 11-0046

April 28, 2011

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Introduction

1. Q. Please state your name and business address.

A. My name is Rochelle Phipps. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

2. Q. What is your current position with the Illinois Commerce Commission?

A. I am a Senior Financial Analyst in the Finance Department of the Financial Analysis Division of the Illinois Commerce Commission ("Commission").

3. Q. Please describe your qualifications and background.

A. I received a Bachelor of Arts degree in Finance from Illinois College, Jacksonville, Illinois. I received a Master of Business Administration degree from the University of Illinois at Springfield. I have been employed by the Commission since June 2000.

4. Q. What is the purpose of your direct testimony?

A. AGL Resources Inc. ("AGL Resources"), Nicor Inc. ("Nicor") and Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas") (collectively, "Joint Applicants") request approval of a reorganization in which Nicor Gas would become a wholly owned subsidiary of AGL Resources.

First, I will present my evaluation of the financial implications of the proposed reorganization under Sections 7-204(b)(4) and (b)(7) of the

Public Utilities Act ("Act"), which states that in reviewing any proposed reorganization, the Commission must find that:

(4) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure; and

(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

Second, I present my evaluation and recommendation pursuant to Section 6-103 of the Act, which requires that in any reorganization of a public utility, the Commission shall authorize the amount of capitalization, which shall not exceed the fair value of the property involved.

Finally, I address whether Joint Applicants' proposed short-term borrowing addendum to the operating agreement (the "Nicor Gas Money Pool") complies with the Commission's rules governing utility money pool agreements (83 Ill. Adm. Code 340).

5. Q. Please describe the proposed reorganization.

A. Pursuant to the Agreement and Plan of Merger among AGL Resources, Apollo Acquisition Corp., Ottawa Acquisition LLC and Nicor, dated as of December 6, 2010 (the "Merger Agreement," provided as Joint Applicants Ex. 1.1), Nicor shareholders will receive $21.20 in cash and 0.8382 shares of AGL Resources common stock in exchange for each share of Nicor common stock.[1] Following the proposed reorganization, Nicor, Apollo Acquisition Corp. and Ottawa Acquisition LLC will no longer exist and Nicor Gas will become a wholly owned subsidiary of AGL Resources.

6. Q. Please summarize your findings and recommendations.

A. In my judgment, the Joint Applicants will not satisfy the requirements set forth in Section 7-204(b)(4) of the Act unless the Commission requires the Joint Applicants to maintain a separate credit facility for Nicor Gas. As such, I recommend a reporting requirement for Nicor Gas in connection with this condition for satisfying Section 7-204(b)(4) of the Act. Furthermore, unless the Joint Applicants present, and the Commission approves, a reasonable methodology for eliminating the adverse rate impacts associated with a decline in Nicor Gas' credit ratings, the Joint Applicants have not demonstrated that the proposed reorganization satisfies the requirement set forth in Section 7-204(b)(7) of the Act. I also recommend a reporting requirement that would address the requirements of Section 6-103 of the Act. Finally, I recommend revisions to Nicor Gas' short-term borrowing addendum that would bring it into compliance with the Commission's rules governing utility money pool agreements.

[1] Joint Applicants Ex. 3.0, p. 3.

Section 7-204(b)(4)

7. Q. How does Nicor Gas currently obtain equity and debt capital?

A. Currently, Nicor Gas obtains equity capital through its parent company, Nicor.[2] Nicor Gas raises debt capital by issuing long-term debt securities and commercial paper. Nicor Gas also has a $400 million 364-day seasonal credit facility that expires April 2012, and Nicor and Nicor Gas share a $600 million, three-year revolving credit facility that expires in April 2013 ("Nicor Gas credit facilities").[3]

8. Q. Does Nicor Gas currently have access to the capital markets on reasonable terms?

A. Yes. Standard & Poor's ("S&P") has assigned Nicor Gas an AA issuer rating. According to S&P, an obligor rated 'AA' has a very strong capacity to meet its financial commitments.[4] Moody's Investors Service ("Moody's") has assigned Nicor Gas an A2 issuer rating, which Moody's considers upper-medium grade and subject to low credit risk.[5] Similarly, Fitch Ratings has assigned Nicor Gas an A issuer rating, which denotes a low expectation of credit risk and a strong capacity for timely payment of financial commitments, although it might be more vulnerable to changes in circumstances or economic conditions than higher ratings.[6] Similarly,

[2] Joint Applicants Ex. 3.0, p. 5.

[3] Joint Applicants Ex. 3.0, pp. 7-8; Northern Illinois Gas Company d/b/a Nicor Gas Company Form 8-K, April 19, 2011.

[4] Standard & Poor's, "Research: Standard & Poor's Rating Definitions," December 10, 2002.

[5] Moody's Investors Service, "Moody's Rating Symbols & Definitions," March 2007, pp. 8 and 11.

[6] Fitch IBCA Rating Definitions, www.fitchratings.com.

Nicor Gas has high-grade commercial paper ratings of A-1+/ P-1/ F-1 from S&P, Moody's and Fitch Ratings, respectively.[7]

9. Q. How would Nicor Gas obtain equity and long-term debt capital following the proposed reorganization?

A. Nicor Gas would have access to the equity markets through its parent company, AGL Resources.[8] Based on the current forecast of capital requirements for Nicor Gas, the Joint Applicants anticipate that, following the proposed reorganization, Nicor Gas would raise long-term debt capital to fund its business in the same manner as it has in the past.[9] However, the Joint Applicants do not expect Nicor Gas to raise any new long-term capital prior to 2016.[10]

10. Q. How is the proposed reorganization expected to affect Nicor Gas' credit ratings?

A. Following the merger announcement in December 2010, S&P placed the 'AA' corporate credit rating and 'A-1+' commercial paper rating of Nicor Gas on CreditWatch with negative implications. Specifically, S&P states:

> The Dec. 7, 2010, CreditWatch placement of Nicor Inc. and Nicor Gas Co. followed AGL Resources Inc.'s announcement that it plans to acquire Nicor…Based on our calculated pro forma credit metrics, we would expect that the

[7] A commercial paper rating with the extension "1" is referred to as a "tier one" rating. Similarly, a commercial paper rating with the extension "2" is referred to as a "tier two" rating.

[8] Joint Applicants Ex. 3.0, p. 5.

[9] Joint Applicants' response to ICC Staff data request RP 9.01.

[10] Joint Applicants Ex. 3.0, p. 5.

> new company's corporate credit rating would be no lower than 'BBB+' when the acquisition closes. Although AGL will fund the transaction with roughly 60% equity, we expect that pro forma credit metrics will be somewhat worse than AGL's current metrics and materially worse than Nicor's. We expect to use a consolidated ratings approach on the new company and will equalize the corporate credit ratings of all entities in the corporate structure.[11]

Similarly, Moody's affirmed the A2 rating of Nicor Gas and changed the outlook to negative from stable. Moody's states, "[t]he negative outlook is based on the expectation that the merger will combine Nicor with AGL resulting in a more leveraged entity which will look to utilize the strong cash flow of Nicor Gas to help service the additional debt to be taken on to consummate this acquisition."[12] Moody's states further:

> Most likely around the time of the merger, [Nicor Gas'] long-term ratings are expected to be downgraded by one notch, assuming that AGL finances this acquisition with sufficient equity to maintain its current Baa1 rating which was affirmed today with a stable outlook. [Nicor Gas'] A2 issuer rating is likely to be downgraded by one notch to conform with those of AGL's rated operating subsidiaries Atlanta Gas Light Company and Pivotal Utility Holdings, which are rated one notch lower at A3 senior unsecured given [Nicor Gas'] expected inclusion in AGL's money pool. [Nicor Gas'] first mortgage bonds will continue to be rated two notches above its issuer rating in accordance with Moody's notching practice for utility mortgage bonds.[13]

11. Q. Does AGL Resources have access to the capital markets on reasonable terms?

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[11] Standard & Poor's, "Summary: Nicor Gas Co.," March 22, 2011.

[12] Moody's Investors Service, "Credit Opinion: Northern Illinois Gas Company," December 8, 2010.

[13] Moody's Investors Service, "Announcement: Moody's Changes Northern Illinois Gas outlook to negative," December 7, 2010.

A. Yes, it does. AGL Resources is currently rated A- by S&P, Baa1 by Moody's and A- by Fitch Ratings and its financing subsidiary, AGL Capital Corporation, which issues long-term debt and commercial paper on behalf of AGL Resources' subsidiaries, is rated BBB+ by S&P, Baa2 by Moody's and A- by Fitch Ratings. According to S&P, an obligor rated 'BBB' has adequate capacity to meet its financial commitments but notes that adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to meet its financial commitments.[14] Moody's considers obligors rated 'Baa' to be subject to moderate credit risk and may possess certain speculative characteristics since they are considered medium grade.[15]

12. Q. What do the rating agencies say regarding the effect of potential refunds to Nicor Gas customers in connection with Performance Based Rates ("PBR") on Nicor Gas' financial metrics?

A. Moody's recognizes there is a risk associated with Nicor Gas' potential PBR-related refunds when it states:

> Nicor Gas has long-standing contingent liabilities related to alleged improprieties in the utility's performance-based rates (PBR) program that was terminated in 2003. In the ICC's investigation, various parties have sought refunds to customers in a range from $109 to $286 million.[16]

Fitch Ratings states:

[14] Standard & Poor's, "Research: Standard & Poor's Rating Definitions," December 10, 2002.
[15] Moody's Investors Service, "Moody's Rating Symbols & Definitions," March 2007, pp. 8 and 11.
[16] Moody's Investors Service, "Credit Opinion: Northern Illinois Gas Company," December 8, 2010.

> …credit concerns related to Nicor Gas' exposure to potential liability payments associated with the Performance Based Rate (PBR) case, which is currently under ICC review, remain…Nicor Gas could be exposed to a significant one-time payment based on current recommendations by the various intervenors in the case, the highest of which is $286 million. Barring an outcome at the higher end of the potential liability range, ratings could be maintained…The [stable] Outlook also assumes that any punitive payments associated with the on-going PBR case will not be significantly larger than modeled.[17]

Finally, S&P states:

> We continue to remain focused on the ICC's ongoing review of Nicor Gas's performance-based rate plan for 1999-2002. However, sensitivities under various Standard & Poor's penalty scenarios do not result in sustained financial ratios at unacceptable levels…We anticipate any financial penalties to result in a one-time revenue reduction for the company, which could result in a short-term deterioration in cash flow metrics.[18]

13. Q. Have the Joint Applicants, their affiliates, or agents, performed analyses of the effect that issuing refunds that might be due to Nicor Gas customers in connection with Docket Nos. 01-0705, 02-0067, 02-0725 (Cons.) would have on the Joint Applicants' financial strength (*e.g.*, cash flows, credit metrics, credit ratings)?

A. Joint Applicants state they have not performed such analyses.[19]

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[17] Fitch Ratings, "Fitch Affirms Nicor Inc. & Northern Illinois Gas IDRs at 'A'; Outlook Stable," October 4, 2010. According to a draft report that was provided in the Joint Applicants' response to ICC Staff data request RP 1.06, Exhibit 2, "For modeling purposes, Fitch has assumed an outlay of up to $200 million, in which event the ratings could be maintained. However, the financial ramifications of any additional punitive actions could have negative rating implications."

[18] Standard & Poor's, "Summary: Nicor Gas Co.," March 22, 2011.

[19] Joint Applicants' responses to ICC Staff data requests RP 3.01 and 3.02.

14. Q. How would the Joint Applicants fund refunds in the amounts recommended by Staff, CUB or the AG in Docket Nos. 01-0705,02-0067, 02-0725 (Cons.)?

A. The Joint Applicants state they have not performed any such analyses.[20]

15. Q. What effect would the proposed reorganization have on the Joint Applicants' ability to issue refunds in the amounts recommended by Staff, CUB or the AG in Docket Nos. 01-0705, 02-0067, 02-0725 (Cons.)?

A. The Joint Applicants state they have not performed any such analyses.[21]

16. Q. Did you assess the effect of refunds on Nicor Gas' financial metrics?

A. Yes. I evaluated the effect of Nicor Gas issuing debt to fund PBR-related refunds up to $286.5 million[22] on the following S&P financial risk benchmarks: (1) funds from operations ("FFO") to debt; (2) debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") and (3) debt to capital. I calculated those benchmarks using Nicor Gas' standalone financial projections for years 2011 and 2012,[23] which I then adjusted to reflect the hypothetical issuance of $169 million,[24] 6.06% 30-

[20] Joint Applicants' response to ICC Staff data request RP 3.03.
[21] Joint Applicants' response to ICC Staff data request RP 3.04.
[22] Docket Nos. 01-0705, 02-0067 and 02-0725 (Cons.), CUB Ex. 1.0 on Reopening Revised (PUBLIC), August 14, 2009, p. 4.
[23] Joint Applicants' response to ICC Staff data request RWB 2.01.
[24] $169 million equals the after-tax effect on cash flow of a $286.5 million refund.

year, BBB-rated utility bonds.[25] Based on my analysis, which results are presented on Attachment 9.1, two of the three financial metrics for Nicor Gas (both of which measure cash flows) would be similar to the significant / aggressive financial risk profile that S&P expects for the consolidated post-merger AGL Resources, Inc. Given that the S&P methodology tends to weight business risk slightly more than financial risk when differentiating among investment grade ratings, the effect of the debt to capital ratio, which exceeds the aggressive S&P financial risk benchmark should not be detrimental to the expected BBB-range credit rating of the consolidated post-merger AGL Resources.[26] Therefore, in my judgment, potential PBR-related refunds up to $286.5 million would not have a significant adverse effect on Nicor Gas' financial metrics.

17. Q. In your judgment, will the proposed reorganization significantly impair the utility's ability to raise necessary long-term capital on reasonable terms?

A. Following the proposed reorganization, Nicor Gas would have lower long-term credit ratings than today. Nevertheless, BBB-rated utilities still have access to the long-term capital markets on reasonable terms. As such, in my judgment, the effect of the proposed reorganization on Nicor Gas'

[25] For the sake of comparison, AGL Capital Corp. recently issued $500 million 30-year bonds at 5.875%. AGL Resources Press Release, "AGL Capital Corporation Announces Public Offering of $500 Million of Senior Notes," March 16, 2011.

[26] Standard & Poor's, "Criteria Methodology: Business Risk / Financial Risk Matrix Expanded," May 27, 2009.

long-term credit ratings will not significantly impair the utility's ability to raise necessary capital on reasonable terms.

18. Q. How would Nicor Gas obtain short-term debt capital following the proposed reorganization?

A. The Joint Applicants state that Nicor Gas would continue its commercial paper program.[27]

19. Q. How would the proposed reorganization affect Nicor Gas' commercial paper ratings?

A. Currently, Nicor Gas' commercial paper ratings are A-1+/P-1/F-1 from S&P/Moody's/Fitch Ratings. Based on my review of credit rating reports, there is no assurance that Nicor Gas would maintain those tier one commercial paper ratings following the reorganization. Both S&P and Moody's have indicated they expect to downgrade Nicor Gas' long-term ratings following the reorganization and there is a strong link between long-term and short-term credit ratings. Specifically, S&P states:

> To achieve an 'A-1+' CP rating the company's credit quality must be at least the equivalent of an 'A+' long-term corporate credit rating. Similarly, for commercial paper to be rated 'A-1', the long-term corporate credit rating would need to be at least 'A-'. In fact, the 'A+/A-1+' and 'A-/A-1' combinations are rare.[28]

[27] Joint Applicants Ex. 3.0, pp. 7-8.
[28] Standard & Poor's, Corporate Ratings Criteria (2008), p. 105.

Similarly, Moody's notes that P-1 short-term ratings typically correspond to A credit ratings and higher while P-2 short-term ratings typically correspond to credit ratings between A and Baa2.[29] Therefore, Nicor Gas is unlikely to maintain tier one commercial paper ratings following the proposed reorganization.

Currently, S&P, Moody's and Fitch Ratings rate AGL Capital Corporation's commercial paper program A-2/P-2/F-2.[30] Those commercial paper ratings more closely correspond to the long-term credit ratings S&P and Moody's expect to assign to Nicor Gas following the proposed reorganization. S&P notes that short-term obligations rated A-2 are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories; however, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.[31] According to Moody's, issuers rated P-2 have a strong ability to repay short-term debt obligations.[32]

20. Q. Are the Nicor Gas credit facilities important with respect to Nicor Gas' ability to access the capital markets on reasonable terms following the proposed reorganization?

[29] Moody's Investors Service, Moody's Rating Symbols & Definitions, March 2007, p. 10.
[30] Joint Applicants Ex. 3.0, p. 4.
[31] Standard & Poor's, "Research: Standard & Poor's Rating Definitions," December 10, 2002.
[32] Moody's Investors Service, "Moody's Rating Symbols & Definitions," March 2007, p. 10.

A. Yes. As noted in the testimony of Mr. Stephen Cave, the daily business funding requirements, including seasonal working capital needs, for Nicor Gas are dependent upon access to the commercial paper markets,[33] which, in turn, depends largely upon Nicor Gas' backup sources of liquidity. Specifically, S&P notes:

> …we have deemed it prudent for companies that issue commercial paper to make arrangements in advance for alternative sources of liquidity. This alternative, backup liquidity protects companies from defaulting if they are unable to rollover their maturing paper with new notes, because of a shrinkage in the overall commercial paper market or some cloud over the company that might make commercial paper investors nervous…The standard for industrial and utility issuers has long been 100% coverage of confidence sensitive paper for all but the strongest credits.[34]

21. Q. Would the existing Nicor Gas credit facilities remain in place following the proposed reorganization?

A. That remains uncertain. Joint Applicants' witness Mr. Stephen Cave states, "Nicor Gas will maintain its separate commercial paper program (and credit facility backstop) to fund its cash working capital requirements."[35] However, both of the credit facilities that Nicor Gas entered into during April 2010 contained change in control provisions. The Joint Applicants indicated they would discuss waiver of the change in control provision with the lenders for both of the Nicor Gas credit facilities when Nicor Gas negotiated renewal of the 364-day revolving facility during

[33] Joint Applicants Ex. 3.0, p. 7.
[34] Standard & Poor's, Corporate Ratings Criteria (2008), p. 106.
[35] Joint Applicants Ex. 3.0, p. 8.

April 2011.[36] Although Nicor Gas entered into a new $400 million, 364-day credit facility on April 19, 2011, which replaced the credit facility that was set to expire in April 2011, it remains unclear whether the new credit facility includes a change in control provision and whether the lenders under the $600 million credit facility agreed to waive the change in control provision. Nevertheless, given the importance of backstop credit facilities in connection with Nicor Gas' commercial paper program, in my judgment, the proposed reorganization will not satisfy the requirement of Section 7-204(b)(4) of the Act unless the Commission requires the Joint Applicants to maintain a credit facility solely for Nicor Gas. To ensure compliance with this condition, I recommend the Commission also require Nicor Gas to file a compliance report following the proposed reorganization, with a copy to the Manager of the Commission's Finance Department, which provides a copy of the Nicor Gas credit facilities that will be in effect following the proposed reorganization.

Section 7-204(b)(7)

22. Q. Please describe the requirement set forth in Section 7-204(b)(7) of the Act and how it relates to Nicor Gas' post-merger capital structure.

A. Section 7-204(b)(7) states, " [i]n reviewing any proposed reorganization, the Commission must find that the proposed reorganization is not likely to

[36] Joint Applicants' supplemental response to ICC Staff data request RP 1.15.

result in any adverse rate impacts on retail customers."[37] Since the cost of capital is a component of a utility's rates, and the cost of capital could increase with financial risk, then an increase in financial risk could increase a utility's rates.

23. Q. Is Nicor Gas' cost of capital likely to increase because of the proposed reorganization?

A. Yes. As a consequence of becoming a subsidiary of AGL Resources, an entity with higher financial risk than Nicor Gas' current parent company, Nicor, Nicor Gas' credit ratings are expected to decline. Lower credit ratings would lead to higher debt costs, which in turn, would lead to higher equity costs as well, since higher debt costs increase financial risk.

24. Q. Could higher financial risk sometimes reduce the cost of capital?

A. Yes. If the higher financial risk is a consequence of an increase in the proportion of debt in the capital structure, the cost of capital could decline due to the resulting increase in weight applied to lower cost debt and a decrease in weight applied to higher cost common equity.

25. Q. What post-merger capital structure do the Joint Applicants propose for Nicor Gas?

A. The Joint Applicants state, "…our current plan is to maintain the equity ratio, excluding any amount related to goodwill, at levels similar to those

[37] 220 ILCS 5/7-204(b)(7).

historically maintained for Nicor Gas."[38] Therefore, there would be no increase in the proportion of debt comprising Nicor Gas' capital structure to offset increases in Nicor Gas' debt and equity costs.

26. Q. Given Nicor Gas is not seeking a rate increase in the instant proceeding, why is Nicor Gas' post-merger cost of capital relevant in the instant proceeding?

A. In my judgment, unless the Commission approves an appropriate methodology for removing from Nicor Gas' cost of capital all incremental risk that results from Nicor Gas' non-utility affiliates in future ratemaking proceedings, Nicor Gas customers would likely suffer adverse rate impacts following the proposed reorganization. That is, unless the Joint Applicants present, and the Commission approves, a reasonable methodology for eliminating the adverse rate impacts associated with a decline in Nicor Gas' credit ratings, the proposed reorganization will not satisfy the requirement set forth in Section 7-204(b)(7) of the Act.

Section 6-103

27. Q. Why is it necessary to review the capitalization of a public utility following a reorganization?

A. Section 6-103 of the Act requires that in any reorganization, the Commission shall authorize the amount of capitalization of a public utility

[38] Joint Applicants Ex. 3.0, p. 10.

formed by a reorganization, which shall not exceed the fair value of the property involved.[39]

28. Q. What effect would the proposed reorganization have on the capitalization of Nicor Gas?

A. The effect of the proposed reorganization on Nicor Gas' capitalization will not be known until after the merger is completed. Following the proposed reorganization, the Securities and Exchange Commission ("SEC") may require fair value adjustments (also referred to as "purchase accounting" and "push down accounting" adjustments) to Nicor Gas' balance sheet. Specifically, Joint Applicants' witness Mr. Stephen Cave states:

> Based on our current analysis, we believe we will meet the requirements to apply the exception afforded by the SEC related to the "pushdown" of goodwill and other adjustments to the books of Nicor Gas related to this transaction (*i.e.*, the impact of the acquisition would not be reflected on the books and records of Nicor Gas)…If pushdown accounting is required…the equity ratio of Nicor Gas will be higher than it is today for book purposes. For future rate-setting procedures, AGL Resources anticipates any goodwill asset and the related equity balance will be disregarded in determining the overall cost of service for Nicor Gas.[40]

The Joint Applicants believe they meet certain requirements that would exempt Nicor Gas from those purchase accounting adjustments; however, their analysis is preliminary. Only after Nicor Gas files its first post-merger financial statements with the SEC would the Joint Applicants know

[39] 220 ILCS 5/6-103.
[40] Joint Applicants Ex. 3.0, pp. 8-9.

whether the SEC agrees with their conclusion that push down accounting adjustments are not required for Nicor Gas.[41]

29. Q. If there are no purchase accounting adjustments to Nicor Gas' balance sheet following the proposed reorganization, then would the proposed reorganization satisfy the requirement set forth in Section 6-103 of the Act?

A. Yes. Absent purchase accounting adjustments, Nicor Gas' capitalization would equal original cost and, consequently, would satisfy the requirements set forth in Section 6-103 of the Act.

30. Q. If there are purchase accounting adjustments to Nicor Gas' balance sheet following the proposed reorganization, then would the proposed reorganization satisfy the requirement set forth in Section 6-103 of the Act?

A. If Nicor Gas' post-merger balance sheet reflects "push down" accounting adjustments, then Nicor Gas' capitalization would not equal original cost and the Commission would have to determine whether the post-merger capitalization of Nicor Gas satisfies the requirements of Section 6-103 of the Act following the proposed reorganization.

31. Q. How do you recommend the Joint Applicants notify the Commission of the post-merger capitalization of Nicor Gas?

[41] Joint Applicants' response to ICC Staff data request RP 2.05.

A. I recommend the Commission require Nicor Gas to file a compliance report with a copy to the Manager of the Commission's Finance Department following the proposed reorganization that describes Nicor Gas' post-merger capital structure and identifies capital structure adjustments that result from the proposed reorganization. No further action would be required if Nicor Gas' post-merger capital structure does not involve any push down accounting adjustments. Yet, if there are push down accounting adjustments to Nicor Gas' balance sheet, then the Commission should also require Nicor Gas to file a petition seeking Commission approval of the fair value study and resulting capital structure for Nicor Gas pursuant to Section 6-103 of the Act.

Nicor Gas Money Pool

32. Q. Please describe the short-term borrowing addendum to the Joint Operating Agreement (Joint Applicants Ex. 6.1).

A. The Commission approved the short-term borrowing addendum, also referred to as the Nicor Gas Money Pool, in Docket No. 06-0796. In its current form, the Nicor Gas Money Pool permits short-term cash advances from Nicor Gas to Nicor Inc., provided Nicor Inc. meets the requirements of 83 Ill. Adm. Code 340.40(b)(1), (2) or (3).[42]

33. Q. How do the Joint Applicants propose to amend the Nicor Gas Money Pool?

[42] Joint Applicants Ex. 6.0, p. 9.

A. The Joint Applicants propose to amend the Nicor Gas Money Pool to permit cash advances from Nicor Gas to 22 non-utility AGL Resources entities, provided those AGL Resources entities meet the requirements of 83 Ill. Adm. Code 340.40(b) Minimum Requirements for Short-Term Loans from Utilities to Affiliates ("Part 340.40(b)").[43]

34. Q. What are the requirements of Part 340.40(b)?

A. According to Part 340.40(b), an affiliate shall be eligible to borrow from the utility if the affiliate meets one or more of the following seven requirements:

1) The affiliate maintains the following commercial paper ratings from at least two of the following three credit rating agencies and a higher, equivalent, or no credit rating from the third rating agency: A-1 or above from S&P; P-1 or above from Moody's; and F-1 or above from Fitch Ratings;

2) The aggregate amount of outstanding short-term indebtedness of the affiliate, including amounts to be borrowed from the utility, excluding amounts drawn on the committed credit facility, does not exceed the unused balance of funds available to the affiliate

[43] Joint Applicants Ex. 6.01, p. 21, and Joint Applicants Ex. 6.1, Exhibit A.

under high-grade committed credit facilities[44] at any time plus the amount of funds the affiliate invests in short-term securities;

3) The affiliate is a high-grade credit issuer;[45]

4) The aggregate amount of funds the affiliate borrows is guaranteed by an affiliate of the utility that meets the requirements set forth in subsection (b)(1);

5) The aggregate amount of funds the affiliate borrows is guaranteed by an affiliate with a high-grade committed credit facility that meets the requirements set forth in subsection (b)(2);

6) The affiliate is a utility;[46] or

7) The affiliate provides the utility cash management services through a Commission approved agreement and the utility does not issue bonds, notes or other forms of indebtedness to entities that are not affiliates of the utility; and

[44] "High-grade committed credit facility" means credit lines that permit the person to draw funds from financial institutions that are high-grade credit issuers. (83 Ill. Adm. Code 340.20)

[45] "High-grade credit issuer" means a company that has the following credit ratings from at least two of the following three major credit rating agencies and a higher, equivalent or no credit rating from the third credit rating agency: A- or above by S&P; A3 or above by Moody's; or A- or above by Fitch Ratings. (83 Ill. Adm. Code 340.20)

[46] "Utility" means, in relevant part, a public utility as defined in Section 3-105 of the Act. (83 Ill. Adm. Code 340.20)

A) The utility is a small utility; or

B) The utility demonstrates that any benefits from relying on an affiliate to provide all the utility's capital exceed the risks associated with a decrease in the utility's financial independence provided the affiliate is a medium-grade credit issuer.[47]

35. Q. Are any of the AGL Resources entities eligible to borrow from Nicor Gas pursuant to the criteria set forth in Part 340.40(b)?

A. No.[48]

36. Q. Do you recommend any changes to the short-term borrowing addendum to the Operating Agreement?

A. Yes. I recommend the Commission approve my proposed changes to the Nicor Gas Money Pool, as presented on Attachment 9.2. Consistent with the requirements of Part 340, my proposed revisions to the Nicor Gas Money Pool would permit Nicor Gas to borrow from non-utility affiliates, but would not permit Nicor Gas to make any cash advances to non-utility affiliates.

Conclusion

37. Q. Please summarize your conclusions.

[47] 83 Ill. Adm. Code 340.40(b).
[48] Joint Applicants' response to ICC Staff data request RP 6.01.

A. In my judgment, the proposed reorganization will not satisfy the requirements set forth in Section 7-204(b)(4) of the Act unless the Commission requires the Joint Applicants to maintain a credit facility solely for Nicor Gas. Further, to ensure compliance with this requirement, I recommend the Commission condition its approval of the proposed reorganization, in part, on my proposed reporting requirement regarding Nicor Gas' post-merger credit facilities.

In my judgment, the proposed reorganization does not satisfy the requirement set forth in Section 7-204(b)(7) of the Act since it does not identify an acceptable means for eliminating the adverse rate impact of the expected declines in Nicor Gas' credit ratings on its cost of capital.

Further, I recommend the Commission condition its approval of the proposed reorganization, in part, on my proposed reporting requirements regarding Nicor Gas' post merger capitalization (Section 6-103 of the Act).

Finally, unless the Commission adopts my proposed revisions to the short-term borrowing addendum to the Operating Agreement, as presented in Attachment 9.2, the Nicor Gas Money Pool will not comply with 83 Ill. Adm. Code 340.

38. Q. Does this conclude your direct testimony?

A. Yes, it does.

Summary Statistics for Nicor Gas

Assuming Nicor Gas Issues 30-Year BBB-Rated Bonds

To Fund $286.5 Million PBR Refunds

	Nicor Gas	S&P Financial Risk Benchmarks		
	2011E – 2012E	Significant	Aggressive	Highly Leveraged
FFO / Debt (%)	XXXXX	20-30%	12-20%	Less than 12%
Debt / EBITDA (x)	XXXXX	3-4X	4-5X	More than 5X
Debt / Capital (%)	XXXXX	45-50%	50-60%	More than 60%

Sources:

Company Response to ICC Staff data request RWB 2.01 Exhibit 1A, pp. 6-9; Citigroup Global Markets, Bond Market Roundup; Strategy, “Data Appendix,” April 15, 2011; and Standard & Poor’s, “Criteria Methodology: Business Risk/ Financial Risk Matrix Expanded,” May 27, 2009.

ADDENDUM

Short-term Borrowing and Investment between Parties

~~Cash advances made by Nicor Gas to an AGLR Entity pursuant to this Agreement shall be in accordance with the following terms and in accordance with 83 Ill. Administrative Code Part 340 (Money Pool Agreements) as adopted by Illinois Commerce Commission (the "ICC") Order effective June 15, 2004 in Docket No. 02-0581, as the same may be amended or modified by the ICC from time to time:~~

~~(a) To the extent that Nicor Gas possesses excess cash and no outstanding short term borrowings, cash advances can be made to an AGLR Entity to the extent that the AGLR Entity meets the requirements of Section 340.40(b); and~~

~~(b) the interest rate on cash advances from Nicor Gas to an AGLR Entity shall be calculated at the higher of (i) the interest rate at which the AGLR Entity could have borrowed the funds pursuant to an existing bank credit agreement(s) or commercial paper facility(ies) entered into between the AGLR Entity and an unaffiliated third party or parties, or (ii) the rate the utility would have earned on existing short term investment accounts maintained during the same period.~~

Cash advances made by an AGLR Entity to Nicor Gas pursuant to this Agreement shall be in accordance with the following terms and in accordance with 83 Ill. Administrative Code Part 340 (Money Pool Agreements) as adopted by ICC Order effective June 15, 2004 in Docket No. 02-0581, as the same may be amended or modified by the ICC from time to time:

(a) The balance of cash advances shall not at any time exceed the unused balance of funds actually available to Nicor Gas under Nicor Gas' existing bank credit agreement(s) or commercial paper facility(ies) entered into between Nicor Gas and an unaffiliated third party or parties; and

(b) the interest rate on cash advances from an AGLR Entity to Nicor Gas shall be calculated at the lower of (i) the interest rate at which Nicor Gas could have borrowed the funds pursuant to an existing bank agreement(s) or commercial paper facility(ies) entered into between Nicor Gas and an unaffiliated third party or parties, or (ii) the AGLR Entity's actual interest cost, including issuance costs, for the funds obtained or used to provide the cash advance to Nicor Gas.