

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AGL RESOURCES, INC., NICOR INC., and)
NORTHERN ILLINOIS GAS COMPANY)
d/b/a NICOR GAS COMPANY)
) Docket No. 11-0046
Application for Approval of a Reorganization)
pursuant to Section 7-204 of the Illinois Public)
Utilities Act)

PUBLIC

Rebuttal Testimony of

GERALD P. O'CONNOR, FCCA

Senior Vice President Finance and Strategic Planning
Northern Illinois Gas Company
d/b/a Nicor Gas Company

On behalf of Joint Applicants

May 26, 2011

1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. Gerald P. O'Connor, 1844 Ferry Road, Naperville, Illinois 60563.

4 **Q. By whom and in what position are you employed?**

5 A. I am the Senior Vice President of Finance and Strategic Planning for Nicor Inc. and
6 Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas" or the
7 "Company").

8 **Q. Are you the same Gerald P. O'Connor who presented Direct Testimony in this**
9 **proceeding?**

10 A. Yes.

11 **II. PURPOSE OF TESTIMONY AND SUMMARY OF CONCLUSIONS**

12 **Q. What is the purpose of your rebuttal testimony?**

13 A. My rebuttal testimony responds to the direct testimony of Illinois Commerce
14 Commission ("Commission") Staff witness David Rearden and Illinois Attorney
15 General/Citizens Utility Board ("AG/CUB") witness David Efron.

16 **Q. What are the conclusions of your rebuttal testimony and how is the testimony**
17 **arranged?**

18 A. After identifying the exhibits attached to this testimony, I address three topics as to which
19 I reach the following conclusions:

- 20 • First, I conclude that the recommendation of Staff witness Rearden that the Joint
21 Applicants have satisfied the requirement of Section 7-204(b)(6) as to the small

22 transportation market served by the Nicor Gas Customer Select program should be
23 extended to the market for traditional transportation customers;

24 • Second, I conclude that AG/CUB witness Effron's assertions regarding purported
25 savings are fundamentally flawed and should be rejected;

26 • Finally, I conclude that statements by Mr. Effron related to the Operating Agreement
27 phase of this proceeding are inappropriately raised at this phase of the proceeding.

28 **III. ITEMIZED ATTACHMENTS / EXHIBITS / FIGURES**

29 **Q. Are you sponsoring any attachments / exhibits / figures?**

30 A. Yes. Attached as Joint Applicants Exhibit 11.1 is a portion of the confidential response
31 to Staff Data Request RWB 2.01, Exhibit 1A and 1B, which reflects Nicor Gas' projected
32 financial performance for the years 2011-2013.

33 **IV. REQUIREMENTS OF SECTION 7-204(b)(6)**

34 **Q. What are the requirements of Section 7-204(b)(6) under the Public Utilities Act (the**
35 **“Act”)?**

36 A. Under this Section, the Commission must find that the proposed Reorganization is not
37 likely to have a significant adverse effect on competition in those markets over which the
38 Commission has jurisdiction.

39 **Q. Has Staff addressed these requirements in direct testimony?**

40 A. Yes. Staff witness Rearden addresses these requirements in testimony.

41 **Q. What was Dr. Rearden's recommendation related to these requirements?**

42 A. Dr. Rearden recommends, in relation to the small transportation market served by the
43 Nicor Gas Customer Select program, the Commission find the proposed Reorganization
44 is not likely to have a significant adverse impact on competition. (Rearden Dir., Staff

45 Ex. 10.0, 7:129-33). Dr. Rearden reserved judgment on the potential impact on the
46 market for larger customers served under traditional transportation rates, because at the
47 time his testimony was submitted he had not received the necessary information to
48 complete his analysis. (*Id.* at 7:133-35). Since that time, information was provided in
49 response to Staff Data Request DTR 2.02, which shows that there are 47 gas suppliers
50 delivering gas to Nicor Gas on behalf of this market and no one marketer delivers more
51 than 21% of the total, indicating wide diversity in the market. In addition, neither Nicor
52 Enerchange nor Sequent Energy is among the top ten gas suppliers for this market.
53 Consequently, this information should satisfy Dr. Rearden's concern and allow him to
54 conclude that the market for traditional transportation customers will also not be
55 adversely impacted by the proposed Reorganization.

56 **V. REQUIREMENTS OF SECTION 7-204(c)**

57 **Q. What are the requirements of Section 7-204(c) of the Act?**

58 A. This Section requires the Commission to make findings on "(i) the allocation of any
59 savings resulting from the proposed Reorganization; and (ii) whether the companies
60 should be allowed to recover any costs incurred in accomplishing the proposed
61 Reorganization and, if so, the amount of costs eligible for recovery and how the costs will
62 be allocated."

63 **Q. Did Staff address these requirements in direct testimony?**

64 A. Yes. On the topic of savings, Staff witness Bridal addressed this issue. (Bridal Dir.,
65 Staff Ex. 7.0, 2:27-3:53). He noted that no savings have been identified, and that any

66 savings resulting from the Reorganization should be reflected in Nicor Gas' next rate
67 case. (*Id.*)

68 **Q. Did any Intervenors address these requirements in direct testimony?**

69 A. Yes. AG/CUB witness Effron claims that as a result of Nicor Gas' 2010 and his
70 projected economic performance, as well as comparing savings from an unrelated
71 reorganization, the Commission must account for savings. (Effron Dir., AG/CUB
72 Ex. 3.0, 6:14-9:11).

73 **Q. Are Mr. Effron's claims correct?**

74 A. No. His assertions regarding earnings contain a variety of errors. First, his claim about
75 Nicor Gas' 2010 economic performance is a red herring. Historical economic
76 performance has no relevance to the required Commission analysis under
77 Section 7-204(c). As I read that Section, it focuses on savings resulting from a
78 reorganization, not past utility economic performance. As such, Mr. Effron's assertions
79 on this point should be rejected.

80 Second, his projected earnings for Nicor Gas for the period of 2011-2012 also are
81 wrong.¹ His projections apply erroneous load growth assumptions as well as selective
82 and biased estimates of rate base changes for 2011 and 2012. (*Id.* at 6:20-8:7).
83 Mr. Effron's selective approach to projecting earnings is inconsistent with the manner in
84 which the Commission has historically set rates. In doing so, he completely ignores
85 Nicor Gas' detailed three year plan submitted in the confidential response to Staff Data
86 Request RWB 2.01, Exhibit 1A and 1B, and which formed a part of the due diligence

¹ While Mr. Effron's calculations correctly reference Nicor Gas' 2010 net income before adjustments for bad debt and weather as \$100.9 million (Effron Dir., AG/CUB Ex. 3.1, Sch. DJE-1), his testimony contains a typographical error in referencing the figure as \$110.9 million. (Effron Dir., AG/CUB Ex. 3.0, 6:20).

87 performed by AGL Resources. (Joint Applicants Ex. 11.1). The projections provided in
88 Nicor Gas' plan are more consistent with the Commission's consideration of all future
89 costs as reflected in the multitude of data points shown in Joint Applicants Exhibit 11.1.²
90 The three year plan projects earnings of [REDACTED]
91 for the three years 2011, 2012 and 2013, respectively, representing a rate of return of
92 [REDACTED] as compared to the authorized rate of return of 8.09%. Put
93 simply, Mr. Effron's attempt to extrapolate future Nicor Gas economic performance has
94 no basis in fact.

95 **Q. Mr. Effron's other basis for claiming that the Reorganization will somehow result in**
96 **a reduction of costs to customers is his reliance on the merger application of WPS**
97 **Resources Corporation and Peoples Energy Corporation, as approved by the**
98 **Commission in Docket No. 06-0540 ("WPS/PEC"). (Effron Dir., AG/CUB Ex. 3.0,**
99 **5:12-23). Are the WPS/PEC merger application and that of the Joint Applicants in**
100 **this proceeding similar?**

101 A. No.

102 **Q. Can you describe the key differences between the WPS/PEC merger and that**
103 **proposed by the Joint Applicants?**

104 A. First, it should be apparent that the merger of WPS/PEC was quite different than the
105 proposed merger of AGL Resources and Nicor Inc. The WPS/PEC merger occurred
106 more than five years ago, and in an entirely different business and economic environment

² These data points include: (a) load growth assumptions relating to Sendout and Deliveries, Normalized Deliveries and Power Generation Deliveries, and Summary of Normalized Annual Sendout and Deliveries 2007 thru 2013 (Joint Applicants Ex. 11.1 at NICOR_NRE 002567, NICOR_NRE 002552, NICOR_NRE 002570, respectively), (b) estimated rate base changes in 2011 and 2012 (*id.* at NICOR_NRE 002574), and (c) three year plan earnings, specifically Statement of Income and Net Income – Actual Weather and Net Income – Normal Weather (*id.* at NICOR_NRE 002553 and NICOR_NRE 002552, respectively).

107 from that experienced by the Joint Applicants. There simply is no basis to equate what
108 transpired in the WPS/PEC transaction to the Joint Applicants' proposed Reorganization.

109 Second, it is my understanding that the WPS/PEC merger did not include any
110 commitment to maintain full time equivalent employee ("FTE") levels at the utility for
111 any period of time. In contrast, as discussed in the testimony of Joint Applicants witness
112 Linginfelter, the Joint Applicants have committed to maintaining the FTE level for three
113 years at Nicor Gas.

114 Third, it is also my understanding that the WPS/PEC merger included detailed
115 projections of annual savings and synergies, as well as costs. As reflected in direct
116 testimony, and as Mr. Linginfelter reaffirms in rebuttal testimony, the Joint Applicants
117 have evaluated and determined that there are no quantifiable savings related to Nicor Gas
118 resulting from the proposed Reorganization.

119 **Q. What do you conclude based on the differences described above?**

120 A. I believe the WPS/PEC merger and the Reorganization proposed by the Joint Applicants
121 in this proceeding are completely dissimilar. There simply is no evidentiary similarity
122 between the two cases.

123 **Q. Mr. Effron uses a Nicor Inc. separation cost estimate of \$21 million to extrapolate**
124 **an assumed savings for Nicor Gas based on WPS/PEC experience. (Effron Dir.,**
125 **AG/CUB Ex. 3.0, 5:1-6:12). Is this a valid methodology to use to estimate savings**
126 **resulting from the Joint Applicants Reorganization?**

127 A. No. As I have previously noted, the two cases are entirely dissimilar and WPS/PEC has
128 no bearing on this proceeding. Mr. Effron's methodology is highly speculative and

129 devoid of a factual basis. Further, the noted separation costs refer to Nicor Inc. and not
130 Nicor Gas.

131 Mr. Effron's claim is further refuted by public information released by AGL
132 Resources to the markets. For example, during a first quarter earnings call held on
133 May 3, 2011, AGL Resources' Chairman, President and Chief Executive Officer, John
134 Somerhalder stated the following about cost savings from the proposed Reorganization:

135 The way we put this very important merger together is really based
136 on long term best practices and scale and scope that can keep costs,
137 over the long term, low for our customers. It's not geared toward
138 immediate near term synergies or savings. There will be some of
139 that in our unregulated businesses and there will be some benefits
140 as we move forward, but that is a different model than we're
141 looking at, what we've talked about. What we provide in addition
142 to those long term benefits for the customers are commitments
143 around distribution ops headquarters, service levels, employment,
144 those type things. So that's the approach we're taking, and that's
145 the approach we'll continue to take.

146 Notably, other than speculation, Mr. Effron fails to point to any direct evidence
147 that such savings will materialize. Indeed, unlike the utilities involved in the WPS/PEC
148 transaction, Nicor Gas is, and has been, the low-cost provider of natural gas distribution
149 service. Mr. Effron does not, and cannot, refute this fact.

150 **Q. As part of his claims concerning Nicor Gas' historical and projected future**
151 **performance, Mr. Effron asserts that the Commission could take certain action**
152 **pursuant to Section 9-202(a) of the Act in an effort to reduce existing rates. (*Id.* at**
153 **9:5-11). Does this assertion have any merit?**

154 **A.** No. As I understand the process, should the Commission exercise its authority under
155 Section 9-202(a), it does so based on actual information reported by the utility, not on

156 speculative, unsupported or incorrect claims. As demonstrated in my testimony above,
157 Mr. Effron's claims concerning Nicor Gas' projected earnings are wrong and unreliable.
158 Indeed, using Mr. Effron's metric of net income as a percentage of average equity, Nicor
159 Gas has *under-earned* in five of the last seven years. Thus, Mr. Effron's suggestion that
160 the Commission undertake action pursuant to Section 9-202(a) is flawed and without
161 merit.

162 **VI. REQUIREMENTS OF SECTION 7-204(b)(2) AND 7-204(b)(3)**

163 **Q. What are the requirements of Sections 7-204(b)(2) and 7-204(b)(3) of the Act?**

164 A. Under Section 7-204(b)(2), the Commission must find that the proposed Reorganization
165 will not result in unjustified subsidization of non-utility activities by the utility or its
166 customers. Under Section 7-204(b)(3), the Commission must find that costs and facilities
167 are fairly and reasonably allocated between the utility and non-utility activities in such
168 manner that the Commission may identify those costs and facilities which are properly
169 included by the utility for ratemaking purposes.

170 **Q. To address these requirements, you included a proposed Operating Agreement as**
171 **an exhibit to your direct testimony. Have there been any changes to that**
172 **Agreement?**

173 A. Yes. The Proposed Operating Agreement has been updated to reflect the following:

- 174 • Settlement agreements between the Joint Applicants, Staff and Intervenors, resolving
175 various issues raised in Docket No. 09-0301 and included in this proceeding;
- 176 • Acceptance of a recommendation proposed by Staff witness Rearden and discussed in
177 the rebuttal testimony of Mr. Linginfelter; and

- 178 • Acceptance of a recommendation proposed by Staff witness Hathhorn and discussed
179 in the rebuttal testimony of Joint Applicants witness Reese.

180 The updated Proposed Operating Agreement was admitted into the record as Joint
181 Applicants Exhibit 7.1 as an attachment to the Agreed Stipulation Between Joint
182 Applicants and Staff admitted into the record as Joint Applicants Exhibit 7.0.

183 **VII. OTHER ISSUES**

184 **Q. Are there other issues raised by Staff or Intervenor witnesses in direct testimony?**

185 A. Yes. AG/CUB witness Effron attempts to interject his recommendations carried over
186 from Docket No. 09-0301, the consideration of the Nicor Gas Operating Agreement
187 (“OA”). (Effron Dir., AG/CUB Ex. 3.0, 11:9-12:3). As noted by Staff witness Hathhorn,
188 “(t)hose issues have been moved to this proceeding and will be considered in the OA
189 phase of this case.” (Hathhorn Dir., Staff Ex. 8.0, 3:68-69). I concur with
190 Ms. Hathhorn’s portrayal of this proceeding. The matters at issue in Docket No. 09-0301
191 have been moved into this proceeding, and have been addressed in five rounds of
192 testimony, and in the evidentiary hearings held on May 23, 2011. There is no basis to
193 relitigate those issues in this phase of the proceeding.

194 **VIII. CONCLUSION**

195 **Q. Does this conclude your rebuttal testimony?**

196 A. Yes.