

REBUTTAL TESTIMONY

OF

DIANNA HATHHORN

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

June 23, 2011

TABLE OF CONTENTS

WITNESS AND SCHEDULE IDENTIFICATION 1

UNCONTESTED RECOMMENDATIONS 2

RECOMMENDATIONS WITH PROPOSED CHANGES BY JOINT APPLICANTS 2

Recommendation #4: Require Annual Internal Audit 2

Recommendation #5: Require Triennial Cost Study 5

Recommendation #6: Require Annual Filing of Billing Report for SA 5

*Recommendation #7: Require Human Resources Indirect Costs Including
 Employee Benefits to be Directly Charged or Assigned 6*

ADDITIONAL RECOMMENDATIONS 6

SUMMARY 7

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. Have you previously testified in this proceeding?

7 A. Yes, my direct testimony is ICC Staff Exhibit 8.0; and my direct and rebuttal
8 testimonies concerning the Operating Agreement issues from Docket No. 09-
9 0301 are ICC Staff Exhibits 1.0 and 3.0, respectively.

10
11 Q. What is the purpose of your rebuttal testimony in this proceeding?

12 A. The purpose of my testimony is to respond to proposed language changes to my
13 recommendations 4, 5, 6 and 7 by AGL Resources Inc., Nicor Inc., and Northern
14 Illinois Gas Company d/b/a Nicor Gas Company (jointly, the "Joint Applicants" or
15 individually, "AGL Resources," "Nicor," or "Nicor Gas").

16
17 Q. What recommendations did you make in your direct testimony?

18 A. I recommended the Commission impose the following conditions listed below in
19 order to find that the Joint Applicants comply with Section 7-204(b)(2) and (b)(3)
20 of the Act:

- 21 1. Amend the Operating Agreement to require AGL Services
22 Company ("AGSC") to pay Nicor Gas fully distributed cost;
- 23 2. Amend the Services Agreement ("SA") to add an access to records
24 paragraph;
- 25 3. Amend the SA to require changes in allocation methods to be filed
26 with the Commission;

- 27 4. Require an annual Internal Audit of the SA;
28 5. Require a triennial cost study of the services provided under the
29 SA;
30 6. Require the annual filing of a billing report for the SA;
31 7. Require that human resources indirect costs be directly charged or
32 assigned;
33 8. Require that the Joint Applicants file an executed copy of the Tax
34 Allocation Agreement on e-Docket; and
35 9. Require that the Joint Applicants file the final disposition of journal
36 entries on e-Docket.
37

38 **Uncontested Recommendations**

39 Q. Joint Applicants state that their Amended Proposed Service Agreement (JA Ex.
40 10.1) and Amended Proposed Operating Agreement (JA Ex. 7.1) include the
41 language changes you proposed to implement your Recommendations #1, 2, 3
42 and 6. (JA Ex. 10.0, p. 3, lines 49-53) Do you agree with Joint Applicants'
43 statement?

44 A. Yes. Further, Joint Applicants state they accept my Recommendations #8 and 9
45 that do not require any language changes to either the Amended Proposed
46 Service Agreement or the Amended Proposed Operating Agreement. (JA Ex.
47 10.0, p. 2, lines 45-48)
48

49 **Recommendations With Proposed Changes by Joint Applicants**

50 **Recommendation #4: Require Annual Internal Audit**

51 Q. The Joint Applicants state that it is appropriate that an annual internal audit be
52 conducted to ensure compliance with the processes outlined in the SA; however,

53 they propose that after three years, the requirement should return to biennial.

54 (JA Ex. 10.0, p. 4) Do you agree?

55 A. No. The Joint Applicants' offer to conduct annual internal audits for three years
56 provides only one additional audit beyond the minimum biennial audit
57 requirement. The Company would still audit each year's activity under its
58 proposal; however, reporting of the results of the audit would be delayed for over
59 a year for one of the two years in every biennial audit period. For example, the
60 results of the audit on calendar year 2015 transactions would not be reported to
61 the ICC until July 1, 2017. This delay significantly diminishes the usefulness and
62 value of information provided in the audit. Further, the Joint Applicants have not
63 distinguished why its annual audit requirement should be different from other
64 Commission-approved affiliated interest agreements and arrangements requiring
65 annual internal audits. (ICC Staff Ex. 8.0, pp. 8-9)

66

67 Q. The Joint Applicants have also proposed a list of "Agreed Upon Procedures" to
68 address your recommendation that the audit requirement should contain specific
69 audit tests. (JA Ex. 10.0, p. 4) Do you agree that the SA should include a
70 description of the specific audit procedures necessary to accomplish the scope of
71 the audit requirements?

72 A. No. My recommendation was to more clearly identify the purpose and scope of
73 the audit. The procedures proposed by the Joint Applicants may accomplish
74 such goals, but those procedures also may need to change or be expanded in
75 the future as operations change. We do not know today the scope of combined

76 operations of Nicor Gas and AGL Resources in the future. The Joint Applicants
77 state that they are in the midst of the first step of an integration process that is
78 not a simple study. (JA Ex. 8.0, p. 6; JA Ex. 8.1) Therefore, it is inappropriate to
79 limit future internal audits to pre-defined audit procedures which may not be
80 adequate to test that the SA with Nicor Gas is being appropriately implemented.
81 Therefore, Joint Applicants' proposed language regarding "Agreed Upon
82 Procedures" should be deleted as I show below.

83
84 Q. The Joint Applicants also provided language changes to your recommended
85 audit tests for the internal audits, whether to be conducted annually or on a
86 biennial basis. (JA Ex. 10.2, p. 3) Do you agree with the Joint Applicants'
87 description of the scope of the internal audits?

88 A. In an effort to limit issues, I agree, with some modifications described below, that
89 the Joint Applicants' language would be an appropriate description of the
90 expectations of the recommended annual internal audit. The modifications I
91 propose are as follows:

92 IX. INTERNAL AUDIT, ANNUAL REPORT AND TRIENNIAL COST STUDY.

93 A. The Company shall file an internal audit report annually ~~for each of the~~
94 ~~first three full calendar years of this Agreement with the ICC's~~
95 Accounting Department Manager no later than July 1 of the following
96 year. The first such report shall cover the year ending December 31,
97 2012. ~~After the initial three year period, the Company shall file an~~
98 ~~internal audit report on a bi-annual basis. The first bi-annual internal~~
99 ~~audit report will cover calendar years ending December 31, 2015 and~~
100 ~~2016.~~ The internal audit report shall reflect the results of an internal
101 audit that tests compliance with the processes outlined in the Services
102 Agreement. Specifically, the internal audit shall identify the top ten costs
103 allocated to the Company from AGSC and using a random sample
104 methodology, identify three costs on which to perform the following
105 tests:

- 106 ~~1. Compare the costs to the prior year;~~
107 ~~2. Compare the costs to the amounts included for similar services in the~~
108 ~~Company's most recent rate case; and~~
109 ~~3. Identify factors that drove the change, including a change in the cost~~
110 ~~for the service itself and the allocation factor.~~

111
112 The internal audit shall also include a review of the allocation factors and
113 the calculation of each to verify that they are updated and calculated in
114 accordance with the Agreement.
115

116 Recommendation #5: Require Triennial Cost Study

117 Q. The Joint Applicants accept your recommendation to perform a study of the cost
118 of services provided under the SA every three years, but propose that the first
119 study should cover the calendar years ending December 31, 2014. (JA Ex. 10.0,
120 p. 5; JA Ex. 10.2, p. 4) Do you agree with Joint Applicants' proposed
121 implementation date of Recommendation #5?

122 A. Yes.
123

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

125 Q. The Joint Applicants accept your recommendation to annually file a billing report
126 that summarizes the monthly charges to Nicor Gas from AGSC under the SA,
127 and have proposed that the billing report for Nicor Gas be in the same format as
128 the bill provided in the response to Staff Data Request DLH-1.06. (JA Ex. 10.0,
129 p. 3; JA Ex. 10.1; JA Ex. 10.2, pp. 3-4) Do you agree with Joint Applicants'
130 proposed format of the billing report required by Recommendation #6?

131 A. Yes, provided that the confidential data on the billing reports is provided at the
132 same time of filing to Staff. Therefore, I propose the following language change
133 to JA Ex. 10.2:

134 B. The Company shall file no later than May 1 annually a billing report on
135 the ICC's e-docket system in Docket No. 11-0046 with a copy to the
136 ICC's Accounting Department Manager and to the Office of the Chief
137 Clerk of the ICC. The billing report shall summarize the monthly
138 charges to the Company from AGSC under the Agreement and shall
139 be in the same format as the bill provided in response to Discovery
140 Request DLH1.06 in the above-referenced Docket. Any confidential
141 data in the billing reports shall be provided to the ICC's Accounting
142 Department Manager at the time of filing on e-Docket.
143

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

146 Q. The Joint Applicants state that they accept your recommendation that the indirect
147 costs associated with human resources costs, including pension expense, health
148 care expense, retirement savings expense, and payroll taxes should be directly
149 assigned, and state that due to the complexity of this calculation and the need for
150 system changes to be made in order to support it, the recommendation should be
151 effective July 1, 2012. Do you agree with Joint Applicants' proposed
152 implementation date of Recommendation #7?

153 A. Yes.

154
155 **Additional Recommendations**

156 Q. Do you have any additional recommendations?

157 A. Yes, I do.

158 I recommend that a revised SA reflecting all agreed upon language changes be
159 attached to the Joint Applicants' surrebuttal testimony and be submitted for the
160 record.

161 I also recommend that as a condition of the reorganization's approval, the Joint
162 Applicants be required to file a semi-annual compliance report on the ICC's e-

163 Docket system in Docket No. 11-0046, reporting the status of its progress of all
164 conditions imposed by the Commission in this case. This reporting requirement
165 should remain in effect until all conditions have been satisfied or the Joint
166 Applicants petition the Commission and receive approval to cease such reporting
167 requirement, whichever comes first.

168

169 **Summary**

170 Q. Please summarize the conclusions and recommendations contained in your
171 testimony.

172 A. I conclude:

173 1) Joint Applicants have accepted five of nine recommendations necessary to
174 find that the proposed reorganization complies with Sections 7-204(b)(2) and
175 7-204(b)(3) of the Act:

- 176 1. Amend the Operating Agreement to AGSC to pay Nicor Gas fully
177 distributed cost;
- 178 2. Amend the SA to add an access to records paragraph;
- 179 3. Amend the SA to require changes in allocation methods to be filed
180 with the Commission;
- 181 8. Require that the Joint Applicants file an executed copy of the Tax
182 Allocation Agreement on e-Docket; and
- 183 9. Require that the Joint Applicants file the final disposition of journal
184 entries on e-Docket.

185 2) Subject to the imposition of the conditions accepted by the Joint Applicants, I
186 have no further objections to the Operating Agreement;

187 3) I continue to propose the remaining four of my original recommendations, but
188 have made slight modifications to them in response to the Joint Applicants'
189 rebuttal testimony. The following recommendations are necessary in order

190 for the Commission to find that the Joint Applicants' compliance with Section
191 7-204(b)(2) and (b)(3) of the Act will be satisfied:

- 192 4. Require an annual Internal Audit of the SA;
- 193 5. Require a triennial cost study of the services provided under the
194 SA;
- 195 6. Require the annual filing of a billing report for SA; and
- 196 7. Require that human resources indirect costs be directly charged or
197 assigned.

198 Subject to the imposition of conditions listed above on the Joint Applicants, I
199 recommend that the Commission approve the proposed SA, the proposed
200 Tax Allocation Agreement, and the proposed accounting treatment of the
201 reorganization.

202 4) I recommend the Commission impose a reporting condition upon the Joint
203 Applicants to file a semi-annual compliance report on the ICC's e-Docket system
204 in Docket No. 11-0046, reporting the status of its progress of all conditions
205 imposed by the Commission in this case until all conditions have been satisfied
206 or the Joint Applicants petition the Commission and receive approval to cease
207 such reporting requirement, whichever comes first.

208
209 **Conclusion**

210 Q. Does this question end your prepared rebuttal testimony?

211 A. Yes.