STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AGL Resources, Inc., Nicor Inc., and Northern Illinois Gas Company d/b/a Nicor Gas Company Application for Approval of a Reorganization pursuant to Section 7-204 of the Public Utilities Act.	)))))))	Docket No. 11-0046

MOTION TO STRIKE
PORTIONS OF THE SURREBUTTAL TESTIMONY OF STEPHEN CAVE

NOW COMES Staff ("Staff") of the Illinois Commerce Commission ("Commission"), by and through its undersigned counsel, pursuant to Section 200.190 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.190), and respectfully submits this Motion to Strike Portions of the Surrebuttal Testimony of Stephen Cave. In support thereof, Staff states as follows:

I. Introduction and Background

On January 18, 2011, AGL Resources Inc. ("AGL Resources"), Nicor Inc. ("Nicor"), and Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor Gas") (collectively the "Joint Applicants") filed with the Commission an Application for Approval of a Reorganization pursuant to Section 7-204 of the Illinois Public Utilities Act ("Act"), (220 ILCS 5/7-204) Pre-filed testimony has been submitted pursuant to the procedural schedule and the evidentiary hearings are scheduled for July 19 through 22, 2011.

In surrebuttal testimony, the Joint Applicants propose for the first time a new, vague approach to Staff's criticism that their proposal to submit a study regarding the impact of the proposed reorganization on the cost structure of Nicor Gas. This is an

entirely new position offered for the first time at the surrebuttal phase of testimony. The testimony to which Staff objects is as follows:

> **Q. Do the Joint Applicants propose a specific methodology to address Ms. Phipps' concerns about the impact on rates for retail customers of any changes in financing costs as a result of the proposed reorganization?**
>
> A. Yes. For the three-year period following the closing of the proposed reorganization, in any proceeding involving rates where an underlying determinant factor is the cost of capital, the Joint Applicants agree that the appropriate debt and equity costs should be based on a study that assumes Nicor Gas' credit rating to be the same as its rating immediately prior to the closing of the reorganization. Further, in any future proceeding involving rates, beyond that three-year period, where cost of capital is an underlying determinant factor, the Joint Applicants agree to file a study addressing applicable requirements of Section 9-230 of the Act, including (to the extent required by that Docket No. 11-0046 8 Joint Applicants Ex. 14.0 provision of law as it then exists) analyzing the impact, if any, of Nicor Gas' affiliation with AGL Resources and its other subsidiaries on the cost of capital for Nicor Gas. The Joint Applicants understand that such an analysis may result in a reduction to Nicor Gas' calculated required rate of return where such a reduction is consistent with the facts and the law as it exists at the time of that future filing. However, we believe this methodology provides a highly transparent means for the Commission to properly assess any cost of capital changes that result from the proposed reorganization in the proper forum, which is in the context of the next rate proceeding, as governed under Section 9- 230 of the Act.

Staff objects to this portion of the prefiled surrebuttal testimony of Joint Applicants witness, Stephen Cave (JA Ex. 14.0, pp. 7-8, ll. 149-168).

II. Argument

Staff testified that the proposed reorganization does not satisfy the requirements set forth in Section 7-204(b)(7) of the Public Utilities Act ("Act") since it does not identify a specific, effective means for eliminating the adverse rate impact of the expected decline in Nicor Gas' credit ratings. (Staff Ex. 15.0, p. 6) In rebuttal testimony, the Joint Applicants proposed to submit a study regarding the impact of the Reorganization on

the cost structure of Nicor Gas, including an analysis of any changes in financing costs. (J.A. Ex. 9.0, p. 9) In response, Staff described the problems inherent in the Joint Applicants' proposal and explained that the proposed study would not enable the Commission to fulfill its statutory obligations under Section 9-230 of the Act and, therefore, would result in an adverse rate impact on retail customers, which would violate Section 7-204(b)(7) of the Act. (Staff Ex. 15.0, pp. 3-4)

In surrebuttal testimony, the Joint Applicants offer a new proposal that goes far beyond the proposal offered in rebuttal testimony. According to the Joint Applicants' surrebuttal proposal (hereafter, the "Surrebuttal Proposal"), in any rate proceeding during the three years immediately following the closing date of the reorganization, the appropriate debt and equity costs should be based on a study that assumes Nicor Gas' credit rating to the be the same as its rating immediately prior to the closing of the reorganization. In rate proceedings following the three-year anniversary of the closing date of the reorganization, the Joint Applicants propose to file a study addressing the requirements of Section 9-230 of the Act, including analyzing any impact of Nicor Gas' affiliation with AGL Resources and its other subsidiaries on Nicor Gas' cost of capital. (J.A. Ex. 14.0, pp. 7-8)

The Surrebuttal Proposal fails to satisfy the requirements of Section 7-204(b)(7) and, more importantly, the timing of the Surrebuttal Proposal prejudices Staff because the schedule that has been established for this case does not provide an adequate opportunity for Staff to describe the deficiencies inherent in the Surrebuttal Proposal.

There are three categories of problems with the Surrebuttal Proposal: (1) the portion of the proposal that would govern the first three years following the merger; (2)

years four and beyond; and (3) problems inherent in the overall conception of the proposal.

Surrebuttal Proposal: Years 1 through 3

First, adjusting debt and equity costs to the pre-merger credit ratings implies that the capital structure needed to support the pre-merger credit ratings is reasonable for establishing utility rates. Otherwise, there would be a mis-match between the capital structure and the costs of debt and equity. Consequently, by virtue of adopting the Surrebuttal Proposal, the Commission would also be ruling that the appropriate capital structure for Nicor Gas should be sufficiently strong (and costly) to support AA/A2 credit ratings. Second, even if estimating a hypothetical cost of debt for post-merger Nicor Gas is relatively straightforward, the same does not hold true for estimating post-merger Nicor Gas' cost of equity based on a hypothetical credit rating. Finding a sample of utilities comparable in risk to a company with observable risk indicators (*i.e.*, operating and financial ratios) is difficult enough. Calculating an adjustment to that sample's cost of common equity due to differences in risk between that sample and a company with a hypothetical credit rating that meets the legal standards of Section 9-230 is problematic and would rely largely on guesswork rather than rigorous quantitative analysis. Consequently, the Commission could not know whether it has met its obligations to remove the last iota of the increase in cost of common equity of Nicor Gas' affiliation with non-utility and unregulated companies.

Surrebuttal Proposal: Year 4 and Beyond

Staff also notes that the second part of the Surrebuttal Proposal, which is to provide a study addressing the requirements of Section 9-230 of the Act, including

analyzing any impact of Nicor Gas' affiliation with AGL Resources and its other subsidiaries on Nicor Gas' cost of capital, is more vague than the study offered for the first three years. It is unclear whether this latter study would provide hypothetical debt and equity cost rates, adjust the capital structure, or take a different approach altogether. Importantly, it is not clear what entity would perform this study or how many years this condition would remain in place following the reorganization. Although Section 9-230 requirements are indefinite, the value of a study that compares post-merger Nicor Gas with a Nicor Gas that no longer exists would surely diminish as the time horizon lengthens.

Surrebuttal Proposal; Conceptual Concerns

The Surrebuttal Proposal is overly complicated and does not specifically address Staff's overarching concern regarding the potential for including even one iota of incremental cost in Nicor Gas' cost of capital due to its affiliation with unregulated and non-utility companies, which would violate Section 9-230 of the Act. If the Joint Applicants intend to maintain Nicor Gas' current equity ratio following the proposed reorganization, despite the likely downgrade of Nicor Gas' credit ratings, then a more direct approach would be to apply the Company's actual debt and equity costs to a hypothetical capital structure that reflects a level of risk commensurate with Nicor Gas' post-merger credit ratings. This approach renders estimating debt and equity cost rates unnecessary, eliminates the need for post merger studies, and mitigates the challenges inherent in estimating the cost of equity based on differences in credit rating alone. In addition, by aligning Nicor Gas' capital structure and capital component cost rates, this

approach would effectively remove any incremental cost resulting from a potential mismatch between the Company's post-merger capital structure, debt and equity costs.

Finally, the Surrebuttal Proposal does not identify the entity that would perform the study. That question warrants attention since a study performed by either the Joint Applicants or an agent on behalf of the Joint Applicants would require the same scrutiny as the rate case filing itself, which may place a greater burden on Staff than would exist without the study. Frankly, Staff is skeptical that any study performed under the control of the utility would ever find that a reduction in Nicor Gas' authorized rate of return is necessary to meet the requirements of Section 9-230.

In summary, none of the concerns Staff identifies here, not to mention concerns that could surface with proper time to evaluate the surrebuttal proposal, are in the record. That is, unless Staff's motion to strike the mention of this surrebuttal proposal is granted, the Joint Applicants' highly problematic Surrebuttal Proposal will be part of the evidentiary record with no testimony that identifies its shortcomings. For all the foregoing reasons, Staff's Motion to Strike should be granted.

WHEREFORE, for the foregoing reasons Staff respectfully requests that the following portions of the Ameren Illinois Utilities' surrebuttal testimony be stricken:

- Joint Applicants Ex. 14.0, p. 2, l. 31, beginning with "We" through l. 34; and
- Joint Applicants Ex. 14.0, pp. 7-8, ll. 149-168.

July 12, 2011

Respectfully submitted,

_____

Jennifer L. Lin
Janis E. Von Qualen
Megan C. McNeill

Staff Counsel

JANIS E. VON QUALEN
Office of General Counsel
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701
Phone: (217) 785-3402
jvonqual@ icc.illinois.gov

JENNIFER L. LIN
MEGAN C. McNEILL
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle St., Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
jlin@icc.illinois.gov
mmcneill@icc.illinois.gov

VERIFICATION

I, Rochelle Phipps, being first duly sworn, depose and state that I am a Senior Financial Analyst in the Finance Department of the Financial Analysis Division of the Staff of the Illinois Commerce Commission; that I have read the foregoing Motion to Strike Portions of the Surrebuttal Testimony of Stephen Cave, and know the contents thereof; and that the statements contained in the Motion are true, correct to the best of my knowledge, information and belief.

Rochelle Phipps
Rochelle Phipps
Illinois Commerce Commission

Subscribed and sworn to before me
this 12th day of July, 2011.

Notary Public

OFFICIAL SEAL
LISA BOWMAN
NOTARY PUBLIC, STATE OF ILLINOIS
MY COMMISSION EXPIRES 12-9-2011