

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 11-0280
Proposed general increase in rates for gas service.	:	
	:	(cons.)
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	
	:	No. 11-0281
Proposed general increase in rates for gas service.	:	

Rebuttal Testimony of

JOHN HENGTGEN
Consultant
Stafflogix Corporation

On Behalf of
North Shore Gas Company and
The Peoples Gas Light and Coke Company

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1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Identification**

3 Q. Please state your name.

4 A. John Hengtgen.

5 Q. Are you the same John Hengtgen who submitted direct testimony on behalf of The
6 Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore Gas Company
7 (“North Shore”) (together, “the Utilities”) in this consolidated Docket?

8 A. Yes.

9 **B. Purposes of Rebuttal Testimony**

10 Q. What are the purposes of your rebuttal testimony in this proceeding?

11 A. The purposes of my rebuttal testimony are:

12 (1) to respond to certain direct testimony of Illinois Commerce Commission (the
13 “Commission or “ICC”) Staff (“Staff”) witnesses relating to rate base, accepting
14 one rate base adjustment and offering rebuttal to the following proposed rate base
15 adjustments: utility plant in service – forecasted additions, utility plant in service
16 – 2010 actual, gas in storage, materials and supplies, accumulated deferred
17 income taxes (“ADIT”), cash working capital (“CWC”), and capitalized incentive
18 compensation;

19 (2) to respond to portions of the direct testimony of Illinois Attorney General’s
20 Office, Citizens Utility Board, and City of Chicago (collectively “GCI”) witnesses
21 Lafayette Morgan and David Efron relating to rate base, accepting one rate base
22 adjustment and offering rebuttal to the following proposed rate base adjustments:

- 23 utility plant in service – forecasted plant additions, gas in storage, accumulated
24 deferred income taxes and cash working capital;
- 25 (3) to discuss rate base adjustments (due to updating) for Retirement Benefits – Net
26 and ADIT - NOL;
- 27 (4) to sponsor revised rate base Schedules to reflect uncontested adjustments and
28 certain of the above-referenced contested and updated adjustments; and
- 29 (5) to respond to Staff’s position in its direct testimony regarding the Original Cost
30 Determination for the Utilities.

31 **C. Summary of Conclusions**

32 Q. Please summarize the conclusions of your rebuttal testimony.

33 A. In brief, the conclusions of my rebuttal testimony are as follows:

- 34 (1) The Utilities agree with or will not contest two of Staff’s and GCI’s respective
35 rate base adjustments in order to narrow the contested issues in these proceedings.
- 36 (2) The Utilities are willing to agree in principle to several other proposed
37 adjustments by Staff and GCI, however, more up to date information or data
38 should be used to calculate the adjustments. I have included updated calculations
39 based on more up to date information or data in my rebuttal exhibits.
- 40 (3) Updated amounts for the Retirement Benefits - Net and ADIT - NOL are proper
41 and should be included in the Utilities’ revised rate bases.
- 42 (4) The Utilities’ revised Rate Base amounts, \$1,452,760,000 for Peoples Gas and
43 \$192,770,000 for North Shore, are just and reasonable and should be approved by
44 the Commission.

45 (5) The Staff's recommendation for the Commission to approve Staff's Original Cost
46 Determination amounts should be denied and the Utilities' Original Cost
47 Determination figures proposed in my direct testimony should be approved.

48 **D. Itemized Attachments to Rebuttal Testimony**

49 Q. Are you submitting any attachments to your Rebuttal Testimony?

50 A. Yes.

51 (1) Revised Schedule B-1: Jurisdictional Rate Base Summary (NS-PGL Ex. 23.1N
52 and NS-PGL Ex.23.1P).¹

53 (2) Revised Schedule B-2: Summary of Utility Adjustments to Rate Base (NS-PGL
54 Ex. 23.2N and NS-PGL Ex. 23.2P).

55 (3) Adjustment for Utility Plant in Service – Forecasted Additions (NS-PGL
56 Ex. 23.3N and NS-PGL Ex. 23.3P).

57 (4) Adjustment for Utility Plant in Service – 2010 Actual (NS-PGL Ex. 23.4N and
58 NS-PGL Ex. 23.4P).

59 (5) Adjustment for Gas in Storage (NS-PGL Ex. 23.5N and NS-PGL Ex. 23.5P).

60 (6) Gas in Storage – LIFO Layers (NS-PGL Ex. 23.6N and NS-PGL Ex. 23.6P).

61 (7) Adjustment for change in Accumulated Deferred Income Taxes (NS-PGL
62 Ex. 23.7N and NS-PGL Ex. 23.7P).

63 (8) Adjustment for change in Cash Working Capital (NS-PGL Ex. 23.8N and
64 NS-PGL Ex. 23.8P).

65 (9) Adjustment to Retirement Benefits - Net (NS-PGL Ex. 23.9N and NS-PGL
66 Ex. 23.9P).

¹ An "N" or a "P" at the end of the name of an exhibit means that it applies to North Shore or Peoples Gas, respectively.

- 67 (10) Adjustment for ADIT – Repairs (NS-PGL Ex. 23.10N and NS-PGL Ex. 23.10P).
- 68 (11) Adjustment for ADIT – Overheads (NS-PGL Ex. 23.11N and NS-PGL Ex.
69 23.11P).
- 70 (12) Adjustment for ADIT – NOL (NS-PGL Ex. 23.12N and NS-PGL Ex. 23.12P).
- 71 (13) GCI response to NS-PGL GCI 4.01 (NS-PGL Ex. 23.13)
- 72 (14) Staff response to NSPGL 2.04 (NS-PGL Ex. 23.14)
- 73 (15) Ameren Illinois Company - Schedule F-8 filed in ICC Docket Nos. 11-0279/11-
74 0282 (NS-PGL Ex. 23.15)
- 75 (16) Northern Illinois Gas Company – Schedules B-1.1 and F-8 filed in ICC Docket
76 No. 08-0363 (NS-PGL Ex. 23.16)
- 77 (17) Staff response to data request NS-PGL 2.02 (NS-PGL Ex. 23.17)
- 78 (18) Comparison of pass-through tax proposals (NS-PGL Ex. 23.18N and NS-PGL
79 Ex. 23.18P)

80 **II. UNCONTESTED ISSUES**

81 Q. Do the Utilities agree with or accept any of Staff’s or GCI’s proposed adjustments to rate
82 base?

83 A. Yes. For a number of reasons, including the Utilities’ goal to narrow contested issues
84 (without waiving any rights to contest issues in future proceedings), the Utilities have
85 decided to not contest two adjustments proposed by Staff and GCI, respectively. These
86 adjustments are listed below and apply to both Peoples Gas and North Shore:

87 Staff Witness Daniel Kahle (Staff Ex. 1.0):

- 88 ○ Cash Working Capital - prepayments

89 GCI Witness Lafayette Morgan (Corrected GCI Ex 1.0)

- 90 ○ Materials and Supplies - accounts payable (schedule LKM-1.5 PGL and schedule
91 LKM-1.5 NS)

92 **III. CONTESTED ISSUES**

93 **A. Utility Plant in Service - Forecasted Plant Additions**

94 Q. Staff witness Mr. Kahle (Staff Ex. 1.0, pages 3-9) and GCI witness Mr. Efron (GCI
95 Ex. 2.0, pages 4-6) propose adjustments to the utility plant in service for forecasted plant
96 additions and the balances of utility plant in service. Do the Utilities agree with those
97 adjustments?

98 A. No. As described by Utilities witnesses Edward Doerk (NS-PGL Ex. 24.0) and Thomas
99 Puracchio (NS-PGL Ex. 33.0), the Utilities do not agree with the forecasted plant
100 additions and plant balances adjustments made by Mr. Kahle or Mr. Efron. Utilities
101 witness James Schott (NS-PGL Ex. 17.0) also addresses the impact on forecasted
102 expenditures in his testimony related to the federal Tax Relief, Unemployment Insurance
103 and Job Creation Act of 2010. I have reflected the updated numbers described by
104 Mr. Doerk and Mr. Puracchio in my rebuttal rate base and the amounts are shown in NS-
105 PGL Ex. 23.3N and NS-PGL Ex. 23.3P. The derivative adjustments for accumulated
106 deferred income taxes are reflected in my rebuttal rate base and are shown in NS-PGL
107 Ex. 23.7N and NS-PGL Ex. 23.7P.

108 Q. Do you have any other concerns about the proposed forecasted plant and plant balances
109 adjustments of Mr. Kahle and Mr. Efron?

110 A. Yes, I have two other concerns. First, Mr. Kahle made the derivative adjustments to the
111 balances of accumulated depreciation utilizing a percentage relationship that he

112 calculated as shown on Staff Ex. 1.0, Schedule 1.9N and 1.9P, page 1 of 3. I do not agree
113 with this calculation and it is not the proper way to reflect the impact on accumulated
114 depreciation. Depreciation adjustments should be calculated using the applicable
115 depreciation rate instead of a percentage of plant.

116 Second, both Mr. Kahle and Mr. Efron made derivative adjustments to the
117 balances of accumulated deferred income taxes. These adjustments impact the balances
118 of ADIT that exist due to the Utilities being allowed to deduct accelerated depreciation
119 on its tax returns under the Internal Revenue Code. In order to avoid a normalization
120 violation and the possible loss of the use of accelerated depreciation, the Utilities are
121 required to follow a proration calculation in computing the amount of deferred taxes
122 being deducted from rate base when a future test year is used to set rates (Illinois
123 Administrative (“Ill. Admin.”) Code Section 285.7035). It does not appear that Mr.
124 Efron made this proration in the calculations for his adjustments. In response to data
125 request NSPGL-Staff 2.01, Mr. Kahle said he will consider this section in his rebuttal
126 testimony.

127 **B. Utility Plant in Service – 2010 Actual**

128 Q. Staff witness Mr. Kahle (Staff Ex. 1.0, pages 17-18) proposes an adjustment to utility
129 plant in service – 2010 actual for Peoples Gas only. Do the Utilities agree with this
130 adjustment?

131 A. No, there should be adjustments for both of the Utilities, but Mr. Kahle has proposed an
132 adjustment only for Peoples Gas. The Utilities acknowledge and agree that 2010 actual
133 balances for utility plant in service are different than the six months actual and six
134 months forecasted balances reflected in the Utilities’ initial filing. However, Mr. Kahle

135 did not reflect an adjustment for utility plant in service – 2010 actual for North Shore. I
136 believe that it is proper to reflect an adjustment for both utilities. I have reflected the
137 amounts for utility plant in service – 2010 actual for both Peoples Gas and North Shore in
138 their respective rebuttal rate bases and the amounts are shown in NS-PGL Ex. 23.4N and
139 NS-PGL 23.4P along with the proper derivative adjustments to the balance of
140 accumulated depreciation and accumulated deferred income taxes.

141 Q. Do you have any other concerns about the proposed adjustment by Mr. Kahle?

142 A. Yes, I have two other concerns. First, similar to the previous adjustment, Mr. Kahle
143 made a derivative adjustment to the balance of accumulated depreciation utilizing the
144 percentage relationship that he calculated as shown on Staff Ex. 1.0, Schedule 1.12N and
145 1.12P. I do not agree with this calculation and it is not the proper way to reflect the
146 impact on accumulated depreciation. Actual accumulated depreciation amounts at
147 December 31, 2010 should be used and depreciation adjustments for 2011 and 2012
148 should be calculated using the applicable depreciation rate instead of a percentage of
149 plant.

150 Second, similar to the previous adjustment, Mr. Kahle did not reflect Ill. Admin.
151 Code Section 285.7035 when making his adjustment and in response to data request
152 NSPGL-Staff 2.01, Mr. Kahle said he will consider this section in his rebuttal testimony.
153 I have reflected the proper amounts in my rebuttal rate base.

154 **C. Gas in Storage**

155 Q. Staff witness Mr. Seagle (Staff Ex. 8.0, pages 12-16) and GCI witness Mr. Morgan
156 (Corrected GCI Ex 1.0, pages 10-11) propose to reduce the Utilities' gas in storage

157 inventory to reflect an updated forecast of gas prices. Do you agree with the proposed
158 adjustments based on the reduction in gas prices?

159 A. I agree that gas prices have decreased from the assumptions that were used in the direct
160 filings in this case. Peoples Gas and North Shore witness Ms. Gregor is providing
161 rebuttal testimony regarding the reduction in gas prices that have occurred since the
162 initial filing and how the Utilities are proposing to handle this reduction. I have updated
163 the gas in storage amounts in rate base to reflect the most recent gas price discussed by
164 Ms. Gregor and the amounts are shown in NS-PGL Ex. 23.5N and NS-PGL Ex. 23.5P.

165 Q. Staff witness Theresa Ebrey (Staff Ex. 3.0, pages 27-28) and GCI witness Mr. Morgan
166 (Corrected GCI Ex. 1.0) also propose adjustments related to the accounts payable
167 associated with gas in storage. Do you agree with Mr. Morgan's proposed adjustment for
168 the associated accounts payable?

169 A. No, it is incorrect. In response to data request NS-PGL GCI 4.01 (NS-PGL Ex. 23.13),
170 Mr. Morgan indicated that the accounts payable adjustment will be withdrawn because he
171 inadvertently did not consider that the utilities use the Last-in First-Out ("LIFO")
172 accounting method for gas inventory.

173 Q. Do you agree with Ms. Ebrey's proposed adjustment for the associated accounts payable?

174 A. I do not; it is incorrect and should be rejected. Ms. Ebrey's adjustment is calculated a
175 little differently than Mr. Morgan's adjustment but contains the same fundamental flaw.
176 Her adjustment does not reflect that the Utilities account for gas in storage based on the
177 LIFO method of accounting for inventory. In response to data request NS-PGL Staff
178 2.04, part c) (NS-PGL Ex. 23.14), Ms. Ebrey confirmed that she does not believe that the
179 LIFO method should be considered in her calculation. However, since she ignores the

180 LIFO method, the result of her proposal reflects an amount of accounts payable offset
181 against month-end balances of gas in storage that would not exist or, in other words, were
182 not purchased during that month and reflected in inventory.

183 Q. Please describe NS-PGL Ex. 23.6N and NS-PGL Ex. 23.6P.

184 A. NS-PGL Ex. 23.6N and NS-PGL Ex. 23.6P show the month end gas in storage inventory
185 volumes, dollars and LIFO rate for each month of the test year. Peoples Gas has LIFO
186 layers from 1977, 1997, 1998, 1999, 2000, 2003 and 2008. North Shore has LIFO layers
187 from 1977 and 1999. Based on the LIFO method, the Utilities do not reflect current year
188 gas purchases in inventory until the beginning of the year volume of gas is restored or
189 replenished back into inventory. For both Peoples Gas and North Shore this does not
190 occur until August, 2012. From August to November, an amount for current year
191 purchases is reflected in the end of the month inventory balance. Ms. Ebrey's
192 methodology calculates accounts payable amounts for all months of the test year except
193 January, 2012. This exhibit shows that for the months January through July and
194 December, the dollar value of gas that resides in the ending balance of gas in storage is
195 related to inventory purchased years ago. Ms. Ebrey's proposal reflects that there is an
196 amount of outstanding accounts payable related to that gas which clearly is not correct.

197 Q. Do you have any other comments about Ms. Ebrey's response to data request NS-PGL
198 Staff 2.04?

199 A. Yes. In response to part d) of that data request, Ms. Ebrey indicated that her proposal is
200 similar to the methodology used by the Ameren Illinois Company ("Ameren") in its
201 current rate case, Docket Nos. 11-0279/11-0282 Cons. However, Ms. Ebrey did not state

202 the type of inventory methodology that was used by Ameren, even though it was
203 requested.

204 Q. What inventory methodology did Ameren use in its rate case?

205 A. It is my understanding, based on a review of the part 285 filing in those dockets, that
206 Ameren uses a weighted average method of accounting for its gas in storage (see NS-
207 PGL Ex. 23.15).

208 Q. Why is this information important?

209 A. Before a methodology can be applied, it is important to know whether there is an apples
210 to apples comparison. Peoples Gas and North Shore use the LIFO accounting method,
211 while Ameren does not. Certainly different valuation methods can and likely would
212 produce different results.

213 Q. Is the Utilities' methodology similar to Northern Illinois Gas Company ("Nicor") with
214 respect to this issue?

215 A. Yes, based on a review of Schedule B-1.1 and Schedule F-8 of the Part 285 filing from
216 Nicor's most recent rate case, Docket No. 08-0383 (NS-PGL Ex. 23.16), I was able to
217 determine that Nicor uses the LIFO methodology and calculates the associated accounts
218 payable offset similar to the methodology proposed by the Utilities. It is also my
219 understanding that this method was approved by the Commission in ICC Docket
220 No. 08-0363².

221 Q. Do you have any other comments about Ms. Ebrey's proposed adjustment?

² The calculation of associated accounts payable offset in the Nicor rate case was not a contested issue. The Commission concluded that "No adjustment to the amount Nicor seeks for gas in storage is warranted." *In re Northern Illinois Gas Co. d/b/a Nicor Gas Co.*, ICC Docket No. 08-0363 (Order Mar. 25, 2009) at 16.

222 A. Yes, in addition to the LIFO issue discussed above, Ms. Ebrey’s calculation is flawed in
223 another manner. She utilizes the lead time in days from the cash working capital lead/lag
224 study in order to calculate what she refers to as “a more reasonable level of costs that
225 would be included in Accounts Payable” (Staff Ex. 3.0, 28:658-659). The accounts
226 payable offset is intended to measure the amount of gas in storage at month end for which
227 payment has not yet been made. Because utility shareholders have not paid for that gas
228 yet, the amounts should not be in rate base earning a return. However, a lead-lag study
229 measures the amount of time in days that on average it takes a utility to pay for its gas
230 costs. As a result, Ms. Ebrey is trying to compute an amount of accounts payable by
231 utilizing a time period in days. The two are not related and a time period is not an
232 appropriate measure to reflect an amount of accounts payable at month end. For all the
233 above reasons, Ms. Ebrey’s adjustment is incorrect and should be rejected.

234 **D. Materials and Supplies**

235 Q. Staff witness Ms. Ebrey (Staff Ex. 3.0, pages 26-27) and GCI witness Mr. Morgan
236 (Corrected GCI Ex 1.0, pages 8-10) have made adjustments to the associated accounts
237 payable related to materials and supplies. Do you agree with those adjustments?

238 A. I agree with Mr. Morgan’s adjustment, except for some minor calculation errors that he
239 has on his schedule, but I disagree with Ms. Ebrey’s adjustment.

240 Q. Please comment on Mr. Morgan’s adjustment.

241 A. Mr. Morgan uses a two year composite percentage of the monthly debits to the materials
242 and supplies accounts and applies that to the test year. Mr. Morgan’s schedule LKM-5
243 PGL and schedule LKM-5 NS both contain errors but not material errors that would

244 change his adjustment significantly. In order to narrow the contested issues in this case,
245 the Utilities will accept Mr. Morgan's adjustment.

246 Q. Please comment on Ms. Ebrey's adjustment.

247 A. Ms. Ebrey's adjustment is incorrect and should be rejected. Similar to her adjustment to
248 gas in storage, Ms. Ebrey utilizes a lead time in days from the cash working capital
249 lead/lag study in order to calculate what she refers to as "a reasonable level of costs that
250 would be included in Accounts Payable" (Staff Ex. 3.0, 27:641-642). The accounts
251 payable offset is intended to measure the amount of materials and supplies at month end
252 for which payment has not yet been made. Because the amounts have not been paid for
253 yet, shareholders should not be earning a return. However, a lead time from a lead-lag
254 study measures the amount of time in days that on average it takes a utility to pay for its
255 other operation and maintenance expenses. As a result, Ms. Ebrey is trying to compute
256 an amount of accounts payable by utilizing a time period in days. The two are not related
257 and a time period is not an appropriate measure to reflect an amount of accounts payable
258 at month end, and, therefore, the adjustment should be rejected.

259 **E. Accumulated Deferred Income Taxes (ADIT)**

260 Q. GCI witness Mr. Morgan (Corrected GCI Ex. 1.0) proposes an adjustment based on the
261 Utilities' proposal for a 50/50 sharing of the risks with ratepayers related to a tax
262 accounting change to the capitalization of repairs for tax purposes. Mr. Morgan proposes
263 to recognize the full amount of accumulated deferred income taxes in rate base. Do you
264 agree with these adjustments?

265 A. No. Utilities' witness Mr. Stabile provides rebuttal testimony on this issue as to the risks
266 associated with this item.

267 Q. Do you have any comments concerning Mr. Morgan's adjustment?

268 A. Yes. In Commonwealth Edison Company's ("ComEd") last rate case, ICC Docket
269 No. 10-0467, the tax accounting change for repairs was also a contested issue. In that
270 proceeding, an intervenor proposed that the effects of the election be reflected in deferred
271 taxes even though ComEd had not made the election. In rejecting the proposal, the
272 Commission found that ComEd was not imprudent in being cautious with respect to this
273 issue. See *In re Commonwealth Edison Co.*, ICC Docket No. 10-0467 (Order May 24,
274 2011) at 114. In this case, the Utilities, having elected the tax accounting change, are
275 proposing a 50/50 sharing of the risk, which is an equitable proposal given the risks. The
276 final outcome of the election is not yet known. Therefore, the Utilities continue to
277 propose the sharing concept and Mr. Morgan's adjustment should be rejected. I have
278 reflected the 50/50 sharing in my rebuttal rate base.

279 Q. GCI witness Mr. Effron (GCI Ex. 2.0, pages 10-13), proposes two adjustments based on
280 bonus depreciation and overhead capitalization. For the overhead capitalization
281 adjustment, Mr. Effron proposes to recognize the full amount of accumulated deferred
282 income taxes in rate base. Do you agree with these adjustments?

283 A. I agree with reflecting the impact of bonus depreciation, but I do not agree with the
284 amounts proposed by Mr. Effron. Similar to his adjustment to forecasted expenditures, it
285 does not appear that Mr. Effron had taken into account the normalization rules. I have
286 reflected the proper level of ADIT in my rebuttal rate bases. I do not agree with Mr.
287 Effron's proposal to recognize the full amount of ADIT for overhead capitalization.
288 Utilities' witness Mr. Stabile provides rebuttal testimony on this issue and the Utilities

289 are proposing the same 50/50 sharing concept that they have proposed for the repairs
290 issue. I have reflected the 50/50 sharing in my rebuttal rate bases.

291 **F. Cash Working Capital**

292 Q. Have you reviewed Staff witness Mr. Kahle's (Staff Ex. 1.0, pages 7-15) and GCI
293 witness Mr. Morgan's (Corrected GCI Ex 1.0, pages 6-8) cash working capital (CWC)
294 calculations and their recommended adjustments?

295 A. Yes I have.

296 Q. What type of adjustments is Mr. Morgan proposing?

297 A. Mr. Morgan proposes two changes to the Utilities' CWC requirements. The first
298 adjustment is a change to the collection lag with respect to prepayments and the second
299 adjustment is to incorporate into his CWC calculations other operating and maintenance
300 ("O&M") adjustments proposed by GCI.

301 Q. Do you agree with Mr. Morgan's adjustment related to prepayments?

302 A. I agree that an adjustment to the collection lag should be made for prepayments.
303 However, Staff witness Mr. Kahle has proposed a similar adjustment, and I am accepting
304 the methodology of his proposed adjustment. To do both Mr. Kahle's and Mr. Morgan's
305 adjustments would be an incorrect double-counting.

306 Q. Do you agree with Mr. Morgan's adjustment related to incorporating GCI's O&M
307 adjustments?

308 A. No, as I do not endorse or accept GCI's O&M adjustments.

309 Q. Please describe Staff's adjustments to CWC.

310 A. Mr. Kahle proposes three adjustments to the Utilities' CWC requirements. First, he uses
311 Staff's level of test year revenues and expenses in his calculations. Second, he modifies
312 the collection lag for prepayments. Third and the most significant adjustment, Mr. Kahle
313 assigned zero revenue lag days for pass-through taxes.

314 Q. Do you agree with Mr. Kahle's adjustment to utilize Staff's level of test year revenues
315 and expenses in his calculations?

316 A. No, as I do not endorse or accept Staff's level of revenue and expenses. However, I agree
317 that the final amount of the Utilities' CWC requirements should be determined based on
318 the revenues and expense levels ultimately approved by the Commission in this case.

319 Q. Do you agree with Mr. Kahle's adjustment for prepayments?

320 A. Yes, I have included his methodology in the CWC calculations in my rebuttal exhibits.

321 Q. Do you agree with Mr. Kahle's adjustment to assign zero revenue lag days for pass-
322 through taxes?

323 A. No, this proposed adjustment is incorrect.

324 Q. Did the Staff make this proposal in the Utilities' last rate case (ICC Docket
325 Nos. 09-0166/09-0167 Cons.)?

326 A. Yes.

327 Q. How did the Commission rule in that case?

328 A. The Commission rejected that proposal and in the Order stated that Staff's approach
329 improperly ignores the time between when customers are billed for pass-through taxes

330 and when the pass-through taxes are remitted to the Utilities. See ICC Docket
331 Nos. 09-0166/0167, final Order (January 21, 2010) at 24.

332 Q. Has Mr. Kahle provided any new support for assigning zero revenue lag days to pass-
333 through taxes?

334 A. No.

335 Q. What then is his basis for proposing this adjustment?

336 A. It appears that the bases for his proposal are several factually incorrect and/or
337 fundamentally flawed and arbitrary statements that Mr. Kahle makes on pages 11 and 12
338 of his testimony. These statements are: (1) “I consider the revenue lag days associated
339 with pass-through taxes to be zero in the CWC calculation because, in regard to pass-
340 through taxes, there is no lag between a delivery of utility service and the receipt of
341 cash.” and (2) on page 12, he states “By the Companies’ definition, pass-through taxes
342 remitted by ratepayers would not have a revenue lag since pass-through taxes do not
343 represent payment for utility services”. Mr. Kahle also makes several statements on
344 page 12, lines 232-237, which, while conceptually true, appear to indicate that Mr. Kahle
345 misunderstands the Utilities’ request in this case as it refers to including the impact of
346 pass-through taxes in its CWC claim included in rate base.

347 Q. Do you agree with those statements?

348 A. No. These statements are nothing more than a play on words in order to mask the real
349 issue of timing of cash flows. The cash flows related to pass-through taxes are real and
350 unavoidable and the Utilities have reflected that reality in their CWC calculations. I will
351 specifically respond to each of Mr. Kahle’s statements below.

352 Q. Please elaborate on why you do not agree with Mr. Kahle's first and second statements.

353 A. The collection and payment of pass-through taxes are a legal requirement of doing
354 business as gas utilities in the State of Illinois and the various municipalities in which the
355 Utilities provide service. In general, there are three types of taxes that the Utilities
356 consider pass-through taxes. The first are taxes on the Utilities and not on the customers.
357 Included in this group are the Gross Receipts/Municipal Utility Tax, Gas Revenue/Public
358 Utility Tax and the ICC Gas Revenue Tax. These taxes are similar to any other cost of
359 providing utility service. The only difference between these taxes and other costs is that
360 under Illinois law (Sections 9-221 and 9-222 of the Public Utilities Act), separate
361 additional charges are included on the customers' bills for these taxes. Because these
362 taxes are recovered under separate charges and not in base rates, they are excluded from
363 the revenue requirement.

364 The second type of pass-through taxes are taxes on the consumer. Included in this
365 group are the Illinois Gas Use Tax and local municipal gas use taxes. The Utilities are
366 required to collect these taxes either by State statute (35 ILCS 173/5-15) or as part of an
367 agreement with the taxing authority.

368 The third type of pass-through taxes are technically not taxes at all. The Utilities
369 are required by State statute (305 ILCS 20/1, *et seq.*, and 20 ILCS 687/6-1 *et seq.*) to
370 include in their charges for utility service an amount that will be remitted to fund state
371 programs related to energy assistance and renewable energy. Both statutes contain
372 language that states the charges "...assessed by electric and gas public utilities shall be
373 considered a charge for public utility service".

374 In order to comply with these requirements, the Utilities perform many functions.
375 Among other things, these functions include calculating different amounts of
376 pass-through taxes for hundreds of thousands of utility customers, properly billing those
377 taxes, collecting those taxes, preparing numerous tax returns in a given year and remitting
378 those taxes to the various taxing authorities. These activities are part of a vast array of
379 utility services that the Utilities provide to their customers.

380 Q. Do you have additional concerns about Mr. Kahle's second statement?

381 A. Yes. The sentence in my direct testimony on page 22 (Peoples Gas) and page 19 (North
382 Shore) that Mr. Kahle is referencing does not apply to pass-through taxes. It is an
383 explanation of the overall revenue lag. In my direct testimony, I discuss the lags and
384 leads for pass-through taxes on pages 24-27 (Peoples Gas) and 21-24 (North Shore).
385 Specifically in that section of my Peoples Gas testimony, on page 24, I state "the
386 pass-through taxes and energy assistance charges are not recorded as revenue or expense
387 on the income statement... ." Further, on page 25, lines 525-533, I indicate that
388 pass-through taxes are collected from the customers at the same time as all other cash
389 payments and therefore, "As a result the lag for collection of pass-through taxes and
390 energy assistance charges is identical to the revenue lag... ." (The same language
391 appears in my North Shore testimony.) Mr. Kahle appears to have ignored this section of
392 my testimony and, instead, he misapplied an inapplicable section. However, there is no
393 denying the fact that there is a lag between when the Utilities issue bills to customers and
394 payment is received by the Utilities. This fact has not changed since the Utilities' last
395 rate cases.

396 Q. Earlier you stated that Mr. Kahle appears to misunderstand the Utilities' request in this
397 case regarding their request for rate base treatment of the CWC amount (Staff Ex. 1.0,
398 12:232-237). Please explain.

399 A. Mr. Kahle's testimony on lines 232-237 appears to imply that the Utilities are requesting
400 investor financing for pass-through taxes. The opposite is true. As shown on NS-PGL
401 Ex. 23.10N and NS-PGL 23.10P, the Utilities have reflected customer financing of pass-
402 through taxes and a reduction to rate base of \$6,269,000 for Peoples Gas and \$156,000
403 for North Shore.

404 Q. Even if Mr. Kahle's argument that the collection and payment of pass-through taxes are
405 not "utility service" and a lag of zero is assumed to be true, which you have testified it is
406 not, is his proposal of assigning zero lag days inconsistent with his proposal to assign the
407 expense lead days for the payment of pass-through taxes as calculated by the Utilities?

408 A. Yes, it is inconsistent because he has assigned expense lead days as computed by the
409 Utilities to the payment of pass-through taxes even though the pass-through taxes are not
410 recorded by the Utilities as expense on the income statement (PGL Ex. 7.0, page 24,
411 lines 511-516 and NS Ex. 7.0, page 21, lines 452-457). It is not consistent to reflect zero
412 lag days for the collection of pass-through taxes because they are not revenue and then
413 assign expense lead days to the payment of taxes when they are not recorded as expense.

414 Q. Again, assuming that Mr. Kahle's argument that the collection and payment of
415 pass-through taxes are not "utility service" and a lag of zero is assumed to be true, which
416 you have testified it is not, is his proposal of assigning zero lag days and assigning the
417 Utilities' proposed expense lead days incorrect?

418 A. Yes, it is incorrect because the Utilities calculated the lead times based on the timing of
419 cash flows in and cash flows out. Mr. Kahle's proposal eliminates the cash flow in part
420 of the timing difference but does not correct or adjust downward the lead (cash flow out).
421 Mr. Kahle's proposal would indicate that the Utilities collect and hold most of the pass-
422 through taxes for an extremely long period time before remitting them to the appropriate
423 taxing jurisdiction, which is simply not accurate. Under Mr. Kahle's proposal, the
424 Utilities would not be in compliance with the appropriate statutes and ordinances
425 governing the payment of the pass-through taxes.

426 Q. Please explain NS-PGL Ex. 23.18N and NS-PGL Ex. 23.18P.

427 A. This exhibit shows difference between Mr. Kahle's proposal and the Utilities' proposal. I
428 will only explain the Peoples Gas differences but the same conclusions can be drawn for
429 North Shore. Peoples Gas is proposing a negative CWC amount of \$6,269,000 while
430 Mr. Kahle is proposing a negative CWC amount of \$32,800,000. Mr. Kahle's proposal is
431 based on reflecting zero lag days (column H) and the Utilities calculated lead days
432 (column L). Mr. Kahle's proposal indicates that:

- 433 • for the Gross Receipts/Municipal Utility Tax, Peoples Gas holds the
434 amounts 82.88 days (line 2, column J) before remittance.
- 435 • for the Energy Assistance Charges, Peoples Gas holds the amounts 67.39
436 days (line 3, column J) before remittance.
- 437 • for the Gas Revenue/Public Utility Tax, Peoples Gas holds the amounts
438 35.75 days (line 4, column J) before remittance.
- 439 • for City of Chicago Gas Use Tax, Peoples Gas holds the amounts 82.88
440 days (line 5, column J) before remittance.

441 Q. Do these proposals by Mr. Kahle reflect reality?

442 A. No. For the Energy Assistance Charges the amounts are due on the 20th of the month
443 following the month in which they are collected. Even if all the amounts were collected
444 on the first day of the month, which they are not, Peoples Gas could only hold the
445 amounts 51 days (31 + 20) before remittance. For the Gross Receipts/Municipal Utility
446 Tax and City of Chicago Gas Use Tax the tax is due on the last day of the month
447 following the month received. Even if all the amounts were collected on the first day of
448 the month, which they are not, Peoples Gas could only hold the amounts 62 days (31 +
449 31) before remittance. Mr. Kahle's proposal would mean that the Utilities are not in
450 compliance with the payment provisions of the statues or ordinances governing these
451 taxes and charges.

452 Q. Prior to making his proposal, are you aware if Mr. Kahle read the applicable statutes,
453 ordinances or sections of the Public Utilities Act that address these taxes and charges?

454 A. Apparently not. In response to that very question in data request NS-PGL Staff 2.02,
455 Mr. Kahle responded that he only reviewed the tax filings and filing instructions (NS-
456 PGL Ex. 23.17). Had Mr. Kahle reviewed the applicable statues or ordinances, he may
457 have realized that his proposal is not realistic and would put the Utilities out of
458 compliance with the payment provisions contained within the statutes and ordinances.

459 Q. Please comment on Mr. Kahle's response to data request NSPGL-Staff 2.02 regarding
460 this issue.

461 A. It appears that Mr. Kahle believes that for "rate making" purposes, facts are not relevant
462 and have no effect on Peoples Gas' compliance with payment provisions.

463 Q. What are your final comments on Mr. Kahle's proposal to assign zero lag days to
464 pass-through taxes?

465 A. Mr. Kahle's proposal is incorrect, is not based upon facts, does not reflect the reality of
466 the cash flows experienced by the Utilities, is not consistent with the Order in the
467 Utilities' last rate case and in fact is opposite of that Order. His proposal should be
468 rejected.

469 **G. Capitalized Incentive Compensation**

470 Q. Staff witness Ms. Ebrey (Staff Ex. 3.0, page 16-17) states that the Utilities did not make
471 the entries necessary to remove from rate base the capitalized portions of incentive
472 compensation that the Commission disallowed in Docket Nos. 07-0241/0242 (cons.) and
473 Docket Nos. 09-0166/09-0167 (cons.). Do you agree that the entries have not been made
474 as reductions in rate base?

475 A. Yes, I agree that the entries have not been made as reductions in rate base. The Utilities
476 have appealed the incentive compensation issues to the Appellate Court, and the appeals
477 remain pending. However, I agree with Ms. Ebrey that the amount of the previously
478 disallowed capitalized incentive compensation amounts are \$122,000 for North Shore
479 and \$649,000 for Peoples Gas. The test year rate base amounts related to these amounts
480 have not been deducted for the proposed rate bases as set forth in my rebuttal testimony
481 and exhibits.

482 **IV. UPDATED ADJUSTMENTS**

483 **A. Retirement Benefits - Net**

484 Q. Have the Utilities updated their pension assets and other post-employment benefits
485 (“OPEB”) liabilities amounts in rate base?

486 A. Yes, Peoples Gas and North Shore witness Ms. Phillips (NS-PGL Ex. 27.0) provides
487 rebuttal testimony regarding the updated pension assets and OPEB liabilities amounts in
488 rate base. I have included these amounts in NS-PGL Ex. 23.9N and NS-PGL Ex. 23.9P,
489 attached to my rebuttal testimony.

490 **B. ADIT – Net Operating Loss (NOL)**

491 Q. Have the Utilities included an amount for their net operating losses (“NOL”) in rate base?

492 A. Yes, Utilities witness Mr. Stabile (NS-PGL Ex. 26.0) describes in his rebuttal testimony
493 the reason for and the amounts of NOLs that the Utilities have included in rate base.

494 **V. UPDATED RATE BASE**

495 Q. Please describe NS-PGL Ex. 23.1N and NS-PGL Ex. 23.1P, adjusted Schedules B-1.

496 A. As indicated in the foregoing testimony, the Utilities have agreed to or accepted two of
497 Staff’s and GCI’s adjustments (in some instances solely in order to narrow the contested
498 issues) and have provided additional evidence concerning updates of adjustments. The
499 Utilities have revised each of their Schedule B-1’s to reflect the above-mentioned
500 changes. As a result, Peoples Gas’ revised rate base is \$1,452,760,000 and North Shore’s
501 revised rate base is \$192,770,000.

502 I also have attached the following related revised rate base Schedules that provide
503 and support data incorporated in the revised Schedule B-1’s: NS-PGL Exs. 23.1N and
504 23.1P (revised Schedule B-1’s), NS-PGL Exs. 23.2N and 23.2P (revised Schedule B-2’s),

505 NS-PGL Exs. 23.3N and 23.3P (Utility Plant in Service - Forecasted Plant Additions),
506 NS-PGL Exs. 23.4N and 23.4P (Utility Plant in Service – 2010 Actual), NS-PGL
507 Exs. 23.5N and 23.5P (Gas in Storage), NS-PGL Exs. 23.7N and 23.7P (Accumulated
508 Deferred Income Taxes), NS-PGL Exs. 23.8N and 23.8P (Cash Working Capital), and
509 NS-PGL 23.9N and 23.9P (Retirement Benefits-Net), NS-PGL Ex. 23.10N and 23.10P
510 (Repairs), NS-PGL Ex. 23.11N and 23.11P (Overheads) and NS-PGL Ex. 12 (NOL).

511 **VI. ORIGINAL COST DETERMINATION**

512 Q. Have you reviewed Staff witness Mr. Kahle’s proposal regarding the Utilities’ Original
513 Cost Determination (Staff Ex. 1.0)?

514 A. Yes. He has recommended on pages 19-20 of his testimony that the Commission’s Order
515 in these dockets state:

516 “It is further ordered that the \$411,521,000 original cost of plant for North
517 Shore at December 31, 2009, and the \$2,667,300,000 original cost of plant
518 for Peoples Gas at December 31, 2009, as presented in Staff Exhibit 1.0,
519 are unconditionally approved as the original costs of plant.”

520 Q. Do you agree with his recommendation?

521 A. No. Mr. Kahle proposes to decrease Peoples Gas’ original cost determination by
522 \$649,000 and decrease North Shore’s original cost determination by \$122,000 relating to
523 the capitalized incentive compensation not allowed for recovery in the Utilities’ 2007 and
524 2009 rate cases. Such adjustments are inappropriate. Incentive compensation is a
525 contested issue and addressed by Utilities’ witness Ms. Cleary. Furthermore, incentive
526 compensation is an issue on appeal for both the 2007 and 2009 cases. If the Utilities
527 were to prevail, the Commission would have inappropriately reduced their original cost
528 of plant. I recommend that, if the Commission decides to accept Mr. Kahle’s adjustments

529 to the original cost determination, then the Commission's final Order should specify that
530 if a decision in the Appellate Court or another court or a Commission decision on remand
531 or in any other proceeding results in the plant in question being approved, then the
532 original cost amounts should be restored to their full amounts of \$2,667,300,000 original
533 cost of plant for Peoples Gas and \$411,643,000 original cost of plant for North Shore.

534 Q. Does this conclude your rebuttal testimony?

535 A. Yes.